No. 88-1951-CFX
Status: GRANTED

Title: United States, Petitioner
v.
Frances L. Dalm

Docketed:
June 5, 1989

Court: United States Court of Appeals
for the Sixth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Pierce,Robert B.

Entry	Date	Note	Proceedings and Orders
1	Apr 27 1989	G	Application (A88-866) to extend the time to file a petition for a writ of certiorari from May 9, 1989 to June 8, 1989, submitted to Justice Scalia.
2	May 2 1989		Application (A88-866) granted by Justice Scalia extending the time to file until June 8, 1989.
3	Jun 5 1989	G	Petition for writ of certiorari filed.
5	Jun 20 1989		Order extending time to file brief of respondent on the merits until August 4, 1989.
6	Jul 31 1989		Brief of respondent Frances Dalm in opposition filed.
7	Aug 9 1989		DISTRIBUTED. September 25, 1989
8	Aug 21 1989	X	Reply brief of petitioner United States filed.
9	Oct 2 1989		Petition GRANTED.
			**********
11	Oct 16 1989	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
10	Oct 20 1989		Record filed.
		*	Certified copy of C. A. Proceedngs received.
12	Oct 30 1989		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
13	Oct 30 1989		Record filed.
		*	Certified copy of original record received.
14	Nov 16 1989		Brief of petitioner United States filed.
15	Nov 27 1989		SET FOR ARGUMENT WEDNESDAY, JANUARY 10, 1990. (4TH CASE)
16	Dec 5 1989		CIRCULATED.
17	Dec 12 1989	G	Motion of the Solicitor General to permit Christine Desan Husson, Esq. to present oral argument pro hac vice filed.
18	Dec 15 1989	X	Brief of respondent Frances Dalm filed.
19	Jan 3 1990	X	Reply brief of petitioner United States filed.
20	Jan 8 1990		Motion of the Solicitor General to permit Christine Desan Husson, Esq. to present oral argument pro hac vice GRANTED.
21	Jan 10 1990		ARGUED.

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88-1951

No.

Supreme Court, U.S.
FILED
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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Whether the doctrine of equitable recoupment permits a taxpayer to maintain a suit against the United States for the recovery of an erroneous tax payment, when that suit is barred as untimely by Sections 7422 and 6511 of the Internal Revenue Code.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No.

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a) is reported at 867 F.2d 305. The opinion of the district court (App., *infra*, 17a-20a) is not reported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 21a-22a) was entered on February 8, 1989. On May 2, 1989, Justice Scalia extended the time to petition for a writ of certiorari to and including June 8, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 6511 and 7422 of the Internal Revenue Code (26 U.S.C.) are set forth in pertinent part in a statutory appendix (App., *infra,* 23a-24a):

STATEMENT

1. Respondent was appointed administratrix of the estate of Harold Schrier in May 1975. The appointment was made at the request of Clarence Schrier, the decedent's brother and sole beneficiary of the estate. The estate paid respondent fees of $30,000 in 1976 and $7,000 in 1977, which were approved by the probate court. Respondent also received from Clarence Schrier a payment of $180,000 in 1976 and a payment of $133,813 in 1977. In December 1976, Clarence Schrier and his wife filed a gift tax return reporting the $180,000 transfer in that year as a gift to respondent, and respondent paid the reported gift tax of $18,675. The Schriers subsequently were assessed $1,587 in interest and penalties with respect to the 1976 transfer, which they paid and for which respondent reimbursed them. No gift tax return was filed respecting the 1977 payment. App., *infra,* 2a, 17a.

On audit, the Internal Revenue Service (IRS) determined that the payments made by Clarence Schrier to respondent represented additional fees for her services as administratrix of the estate. The IRS accordingly asserted deficiencies in respondent's income tax for the years 1976 and 1977. Respondent petitioned the Tax Court for a redetermination of the asserted deficiencies, contending that the transfers of $180,000 and $133,813 were gifts from Clarence Schrier intended to carry out his brother's intention that respondent share in his estate. In September 1984, after two days of trial, the parties negotiated a settlement of the Tax Court case for one-half the amount of the

asserted deficiencies (excluding penalties), applying $70,639 to pay the 1977 deficiency in full and applying the remaining $10,416 to the deficiency for 1976. App., *infra,* 2a-3a, 17a-18a.

2. In November 1984, respondent filed an administrative claim for refund of the $20,262 in gift tax, interest, and penalties paid with respect to the $180,000 transferred to her in 1976. App., *infra,* 3a. This claim was untimely since it was filed almost five years after the expiration of the three-year limitations period specified in Section 6511 of the Internal Revenue Code.[1] After the IRS failed to act upon the claim within six months, respondent brought this refund suit in the United States District Court for the Western District of Michigan.

The district court granted the government's motion to dismiss for lack of jurisdiction (App., *infra,* 17a-20a). The court rejected respondent's contention that the suit could be maintained under the doctrine of equitable recoupment set forth in *Bull* v. *United States,* 295 U.S. 247 (1935), even though the suit unquestionably was untimely under the applicable statute of limitations. Citing this Court's decision in *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296 (1946), the court concluded that there is no authority for applying equitable recoupment in "an independent lawsuit, such as this suit, * * * maintained for a refund for a year in which the statute of limitations has expired" (App., *infra,* 19a).[2]

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

[2] The district court also observed that the Tax Court settlement appeared designed to reflect the prior payment of gift tax, and therefore that respondent in any event would not be entitled to a refund of that tax (App., *infra,* 20a). The court also stated that, pursuant to Section 6512(a) of the Code, institution of the Tax Court proceeding for 1976 barred this suit for refund of 1976 taxes (*ibid.*).

The court of appeals reversed (App., *infra,* 1a-16a). The court held that the doctrine of equitable recoupment allowed the taxpayer to bring the untimely suit because the payment of the gift tax was inconsistent with the treatment in the Tax Court settlement of the transfers as fees for services rendered. The court of appeals characterized this Court's decision in *Rothensies* v. *Electric Storage Battery Co., supra,* from which the district court had quoted, as narrowing the application of the equitable recoupment doctrine established in *Bull* v. *United States, supra* (see App., *infra,* 6a), but stated that "[t]he facts in *Rothensies* were quite different from those in *Bull* and the present case" (*id.* at 8a).

Citing the Ninth Circuit's decision in *Kolom* v. *United States,* 791 F.2d 762 (1986), the court then stated that there are three prerequisites for the application of equitable recoupment (App., *infra,* 9a-10a): "There must be (1) a single transaction or taxable event, (2) that event must be subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely." The court held that these three criteria were satisfied. With respect to the third criterion, the court stated (*id.* at 10a-11a): "[Respondent's] refund action was not barred by the statute of limitations though filed more than three years after the gift taxes were paid. Her claim for recoupment related to the government's timely deficiency action and was timely as well for purposes of recoupment."[3]

[3] The court of appeals also held that the district court could not grant summary judgment for the government on the alternative ground that the 1976 Tax Court settlement reflected the gift tax overpayment (App., *infra,* 14a-16a). The court of appeals remanded for factfinding on the intent of the parties to the Tax Court settlement (*id.* at 16a).

REASONS FOR GRANTING THE PETITION

The decision below marks a serious departure both from the jurisdictional framework established by Congress to govern tax litigation and from legal principles clearly established by this Court. There is no doubt that the instant suit is untimely under the statute of limitations that governs tax refund suits. And the doctrine of equitable recoupment does not eliminate that statutory bar to suit. A consistent line of cases of this Court, dating from *Bull* v. *United States,* 295 U.S. 247 (1935), as well as numerous court of appeals cases, makes clear that a claim of equitable recoupment must be raised in a timely suit. While the doctrine permits a taxpayer (or the government) to raise *as an offset or credit* a claim that would be time-barred if advanced as the ground for an independent lawsuit, it plainly does not allow a party to commence an action that is barred by the statute of limitations.

If permitted to stand, the decision below would have deleterious consequences for the administration of the tax laws. It would relieve some taxpayers of the need to comply with the conditions prescribed by Congress for obtaining a refund, while taxpayers in other circuits would remain governed by the statute of limitations contained in the Code. And the approach of the court below would upset the goals of finality and repose that Congress sought to advance in establishing a definite statute of limitations for refund suits. Moreover, the uncertainty engendered by the decision below creates difficulties for taxpayers in having to decide whether to pursue their claims in the Tax Court or in district court without knowing how that choice will affect their entitlement to recoupment. It is therefore important for this Court to grant certiorari to correct the court of appeals' misinterpretation of this Court's precedents concerning equitable recoupment and to resolve the resulting conflict in court of appeals decisions.

1. a. Petitioner's refund suit is unquestionably barred by the statute of limitations. Section 7422(a) of the Code provides that no refund suit "shall be maintained in any court * * * until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard." Section 6511(a) of the Code provides that, in the case of a tax (such as the gift tax) with respect to which a return is required, such a claim for refund must be filed "within 3 years from the time the return was filed or 2 years from the time the tax was paid." Section 6511(b)(1) provides that no credit or refund shall be allowed or made unless a timely claim has been filed. Respondent did not file a claim for refund until 1984, long after the expiration of the three-year period prescribed by Section 6511. Accordingly, under the statutory framework erected by Congress, the district court lacked jurisdiction to entertain respondent's refund suit. See, *e.g.*, *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986); *United States* v. *Garbutt Oil Co.*, 302 U.S. 528, 533-535 (1938).

b. The doctrine of equitable recoupment provides no basis for district court jurisdiction where suit is barred by the statute of limitations. The applicability of that doctrine to tax cases has its source in this Court's decision in *Bull* v. *United States, supra.* In that case, the decedent had provided that his estate would continue to receive a share of the earnings from a partnership for a specified period following his death. On audit of the estate tax return, the Commissioner determined that those post-death partnership earnings were part of the value of the partnership interest includible in the gross estate. Subsequently, after additional estate tax had been paid to reflect this increase in the value of the gross estate, the Commissioner determined that the same post-death partnership earnings were also includible in the estate's gross income for income tax purposes. The estate paid the income tax deficiency as-

serted, but thereafter filed a timely refund claim and brought suit for the recovery of that income tax payment. The Court of Claims denied the claim for refund of income tax, finding that the partnership earnings were correctly treated as income of the estate. The court also rejected the estate's alternative contention that, if these earnings were income, it should receive a refund of the estate tax that was paid, finding that it could not consider this claim because the time for filing a refund claim for the estate tax had expired. See 295 U.S. at 254; 6 F. Supp. 141 (Ct. Cl. 1934). This Court reversed. The Court held that, even though the time for filing an independent claim for refund of the estate tax had expired, the doctrine of equitable recoupment permitted the executors to credit the overpayment of estate tax against the correctly-assessed income tax liability that was directly at issue in that refund suit.

Although the Court permitted the estate in *Bull* to reduce its total tax liability by crediting an estate tax payment that could no longer be the subject of a refund suit, the Court made clear that the doctrine of equitable recoupment does not override the jurisdictional bar imposed by a statute of limitations. Rather, the doctrine permits a time-barred claim to be raised only in a defensive way—by seeking an offset or credit against a tax that is the subject of a timely-filed action over which the court properly has jurisdiction. The Court explicitly stated that the inconsistent treatment that the estate suffered in *Bull* "cannot avail to toll the statute of limitations" (295 U.S. at 259). It noted therefore that, even though "[r]etention of the [estate tax overpayment] was against morality and conscience" (*id.* at 260), once the taxpayer had failed to seek a refund of estate tax within the limitations period, "[i]f nothing further had occurred Congressional action would have been the sole avenue of redress" (*id.* at 261). The

estate's ability to recoup the overpayment of estate tax arose only because that claim could be raised defensively in a timely-filed proceeding to determine the estate's income tax liability arising out of the same transaction. The Court summarized the operation of the doctrine of equitable recoupment as follows (*id.* at 262 (emphasis added)):

> If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations *so long as the main action itself is timely.*

In sum, although the facts in *Bull* are similar to those of the instant case in many respects, they differ in one critical respect—*viz.*, that, in contrast to this case, the suit in *Bull* was instituted to recover a tax payment for which a *timely* refund claim had been filed, and the court therefore had jurisdiction over the action.

In subsequent cases, this Court has adhered to the clearly stated position that the doctrine of equitable recoupment can be invoked only to assert a credit against another tax—one that is the subject of either a timely refund claim and refund suit or a pending collection suit brought by the government. In *Stone* v. *White,* 301 U.S. 532 (1937), the Court held that the government also is entitled to invoke the doctrine of equitable recoupment in a timely refund suit by raising an offsetting claim that would be time-barred if raised in an independent suit. The Court explained (*id.* at 538-539): "The statutory bar to the right of

action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

Subsequently, in *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296, 302 (1946), the Court rejected an attempt to invoke equitable recoupment, on the ground that the allegedly inconsistent claims did not arise out of the same transaction. The Court stressed the importance of statutes of limitations, even though in some cases their application may yield what appears to be an inequitable result (*id.* at 301-303), and it expressed its concern that a broad expansion of the doctrine of equitable recoupment beyond the facts of *Bull* "would seriously undermine the statute of limitations in tax matters" (329 U.S. at 302). The Court concluded (*id.* at 303): "If there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them." Thus, the decisions of this Court make clear that equitable recoupment may be invoked only to seek a credit against a related tax claim being litigated in a timely action; it does not provide a basis for ignoring the statute of limitations and bringing a time-barred action, as respondent did in this case.[4]

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[4] See generally Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies,* 28 Ariz. L. Rev. 595, 598-613 (1986); *id.* at 625 ("Under the doctrine of equitable recoupment, the barred claim is only usable to reduce or wipe out the open claim, but no more."); Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax Law. 625, 633-640 (1985); *id.* at 633 ("Recoupment, rather than extending the statute of limitations to correct a perceived injustice, permits a wronged party to recoup the loss against a sum still open to litigation."); *id.* at 635 ("a recoupment claim must not be an independent counterclaim, but must instead be a defense to the main action").

c. As the Court pointed out in *Rothensies,* Congress has the power to create exceptions to the statute of limitations in order to ameliorate inequities caused by inconsistent tax treatment of the same transaction. In the wake of *Bull,* Congress took action in this regard, adopting the "mitigation provisions" now set forth at Sections 1311-1314 of the Code. See Section 820 of the Revenue Act of 1938, ch. 289, 52 Stat. 581. These complex provisions delineate various circumstances under which, in cases of inconsistent treatment, a tax year closed by the statute of limitations will be reopened for the correction of an error. See generally Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax Law. 625, 633-640 (1985); Maguire, Surrey, and Traynor, *Section 820 of the Revenue Act of 1938,* 48 Yale L.J. 509 & 719 (1939). But the application of the mitigation provisions is limited by their terms (see especially § 1312), and the provisions plainly do not provide a blanket exemption from the otherwise applicable statute of limitations in all cases in which a double tax liability has been imposed with respect to a single transaction.

Thus, in situations not covered by the mitigation provisions (such as this case), the doctrine of equitable recoupment may still be invoked, but it may be used only to obtain a credit against another tax being litigated in a timely action. If the court below were correct in holding that equitable recoupment permits a taxpayer to bring an independent time-barred action, then the mitigation provisions, which permit such an independent action only in limited circumstances, would be superfluous, and the restrictions imposed by Congress upon the mitigation remedy would be meaningless.[5] Hence, the very existence

[5] Indeed, the Ninth Circuit in *Kolom* v. *United States,* 791 F.2d 762 (1986), the case upon which the court below relied (see page 13, *infra*),

of the mitigation provisions demonstrates that the court below has misapplied the doctrine of equitable recoupment.

2. a. The courts of appeals generally have recognized that, under *Bull,* equitable recoupment does not authorize a taxpayer to maintain an independent suit that is barred by the statute of limitations. On three separate occasions, the Court of Claims has rejected a taxpayer's attempt to invoke that doctrine as a basis for allowing a time-barred suit for refund. See *Ellard* v. *United States,* 228 Ct. Cl. 815 (1981); *Brigham* v. *United States,* 470 F.2d 571, 577 (Ct. Cl. 1972), cert. denied, 414 U.S. 831 (1973); *Evans Trust* v. *United States,* 462 F.2d 521, 525-526 (Ct. Cl. 1972). The court explained in *Evans Trust* that accepting the taxpayer's contention would have gone well beyond the doctrine established in *Bull* because the taxpayer was "attempting to use recoupment not in its traditional form as a defense to an asserted deficiency, but as an independent ground for reopening years now closed by the statute of limitations" (462 F.2d at 526).

The Seventh Circuit recently rejected the same contention in *O'Brien* v. *United States,* 766 F.2d 1038, 1048-1051 (1985). In that case, the IRS had placed a higher value on shares of stock for estate tax purposes than that reported on the return; applying that value as the basis for the taxpayer's computation of gain realized from the subsequent disposition of those shares would have entitled him to an income tax refund, but the time for filing such a refund

essentially acknowledged that the mitigation provisions become superfluous if equitable recoupment is expanded to permit a taxpayer to maintain an independent action that is barred by the statute of limitations. The court there stated (791 F.2d at 766 n.10): "The doctrine of equitable recoupment essentially requires the same criteria necessary to prove application of the mitigation provisions, the mitigation provisions requiring proof of even further criteria."

claim had expired.[6] Like respondent here, the taxpayer in *O'Brien* filed an untimely refund claim and brought suit to recover the income tax overpayment; he argued in the alternative that the claim should be allowed either under the mitigation provisions or under the doctrine of equitable recoupment. The Seventh Circuit rejected both theories.

The court stated that "it is clear that the doctrine [of equitable recoupment] does not lift the limitations bar to taxpayer's refund suit" (766 F.2d at 1048) because, in contrast to *Bull,* the taxpayer was seeking to invoke the doctrine to maintain an independent, time-barred action, not as a defense in an action that was timely filed. The court explained that "the doctrine requires some validly asserted deficiency or refund against which the asserting party desires to recoup a time-barred refund or deficiency * * * and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (766 F.2d at 1049). The court then summarized its holding as follows (*ibid.*; footnote omitted):

> Attempts by taxpayers to utilize the doctrine to revive an untimely affirmative refund claim, as opposed to offset a timely government claim of deficiency with

[6] The taxpayer had received shares of stock from his father that were later included in the father's gross estate as gifts in contemplation of death (see I.R.C. § 2035). The estate valued the stock at $215 per share for this purpose, and the taxpayer used that same value as his basis in the stock for purposes of computing gain on the subsequent liquidation of the corporation. The IRS asserted an estate tax deficiency, claiming a higher value for the shares in question. The ensuing Tax Court litigation brought by the estate resulted in valuation of the stock at $280 per share. If the same value were applied to the shares for purposes of computing the gain realized on the liquidation, the taxpayer would have been entitled to a refund of part of the income tax he had paid on the reported gain. But the taxpayer failed to file a timely income tax refund claim to protect his position pending the outcome of the estate tax dispute.

> a barred claim of the taxpayer, have been uniformly rejected. * * * Plaintiff has invoked the doctrine in this precise manner and therefore the district court's holding that equitable recoupment permits the taxpayer's time-barred refund claim must be reversed. O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax and does not seek to offset the amount of a properly asserted and timely deficiency.

b. The consistent adherence of the courts of appeals to *Bull* and its prohibition against the use of equitable recoupment to nullify the statute of limitations' bar to an independent action was disturbed in 1986 by the Ninth Circuit's decision in *Kolom* v. *United States,* 791 F.2d 762. In that case, the IRS disputed the year for which the taxpayer had reported and paid certain minimum tax liability, arguing that it should have been reported in 1972, not 1973. After litigation in the Tax Court, its determination of a deficiency for 1972 was upheld. The taxpayer, who had allowed the time for filing a refund claim for 1973 to expire, sought to file an untimely claim in reliance on the mitigation provisions. The Ninth Circuit held that the mitigation provisions were inapplicable but it then proceeded to rule on its own motion (see *id.* at 766 n.10) that the taxpayer's refund suit could be maintained under the doctrine of equitable recoupment. Ruling without the benefit of briefing on the equitable recoupment issue, the court reasoned that the doctrine may be invoked to nullify the statute of limitations whenever the government has been "unjustly enriched" by inconsistent treatment of a single transaction (*id.* at 766-767), and it accordingly applied the doctrine to allow the taxpayer's independent time-barred suit.[7]

[7] The holding in *Kolom* was criticized in the one law review article on equitable recoupment published subsequent to the decision. See

The court of appeals below has now followed the Ninth Circuit's approach in *Kolom* and discarded the established principle that equitable recoupment may be invoked only as a defense or credit in a timely-filed action. Respondent could have planned her litigation so as to enable her to claim a credit for the gift tax overpayment under a theory of equitable recoupment in a timely-filed income tax refund suit (see pages 17-18, *infra*), but she did not pursue that option and the court of appeals has erred in holding that the doctrine can nullify the jurisdictional bar against an independent suit that is established by a statute of limitations. Not only does the court's ruling conflict with this Court's decisions in *Bull* and its progeny, it presents a direct conflict in the circuits with *O'Brien* and with the Court of Claims cases, which are binding precedent in the Federal Circuit. The court of appeals' attempts to reconcile the contrary decisions are completely unpersuasive. With respect to the Court of Claims cases, the court of appeals stated that "at least one element required for the application of recoupment was missing" (App., *infra,* 14a), without acknowledging that the defect identified by the Court of Claims in each of the cases was the attempt to invoke equitable recoupment, not as a defense, but as an independent basis for jurisdiction over a time-barred refund suit (see page 11, *supra*).

Andrews, *supra,* 28 Ariz. L. Rev. at 626 n. 193:

> The Ninth Circuit is simply incorrect in this regard because if equitable recoupment is a permissible basis for a refund suit for the barred year rather than the open year, then it completely undercuts the statute of limitation. That this is true is evident from the fact that, in such case, it no longer operates merely to diminish the opposing party's right to recover, but, instead, is serving as an independent ground for obtaining a refund that is directly barred by a statute of limitation.

Similarly, the Seventh Circuit's decision in *O'Brien* cannot be reconciled with the decision in this case. The court below sought to distinguish *O'Brien* on the ground that the refund suit was not addressed to a tax for which a timely deficiency had been asserted; rather, the taxpayer had voluntarily paid the tax in question when he filed his return (see App., *infra,* 11a-13a). But this factual distinction is immaterial. First, the decision in *O'Brien* nowhere suggests that the absence of a deficiency notice played any role in the court's decision; to the contrary, the opinion focuses entirely on the taxpayer's misguided attempt to invoke equitable recoupment to maintain an independent time-barred suit. Second, it is not apparent why the issuance of a timely deficiency notice should be a prerequisite to an equitable recoupment claim; indeed, this proposition cannot be squared with this Court's decision in *Stone* v. *White, supra,* where the government was permitted to claim equitable recoupment in the taxpayer's timely refund action although the government's independent claim to a deficiency was time-barred. Third, the Seventh Circuit's opinion itself demonstrates that it would not agree with the basis for decision proffered by the court below. According to the court below, the absence of a timely deficiency notice absolutely barred the taxpayer in *O'Brien* from raising an equitable recoupment claim in any manner; the Seventh Circuit, however, noted that he could have raised such a claim in a timely estate tax refund action (766 F.2d at 1050).[8] Rather, the Seventh Circuit's

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[8] The court below also mistakenly read one footnote in *O'Brien* as supporting the use of equitable recoupment to maintain an independent time-barred claim (App., *infra,* 12a-13a). That footnote in *O'Brien* merely notes the settled proposition that a taxpayer can raise equitable recoupment as an offset not only in a collection suit by the United States, but also in a refund suit that the taxpayer has commenced to challenge an asserted tax liability that he has paid, so long

holding in *O'Brien* rests squarely and entirely on the ground "that the doctrine [of equitable recoupment] cannot be used 'as an independent ground for reopening years now closed by the statute of limitations' [citing *Evans Trust* v. *United States*, 462 F.2d at 526], and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (766 F.2d at 1049).[9] In sum, the decision below clearly conflicts with the governing precedent in the Seventh and Federal Circuits.

3. The decision below, if permitted to stand, will disrupt the sound administration of the tax laws. The decision would have the effect of "completely undercutting" the statute of limitations in a discrete class of cases (see Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 625, 626 n.193 (1986)), thereby permitting the courts to entertain lawsuits in defiance of the limitations on jurisdiction and on suits against the United States that have been specifically established by Congress. The decision below would thus undermine the goals of finality and repose that Congress sought to advance by establishing a statute of limitations for taxpayer refund suits. As this

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as the refund suit is timely. See 766 F.2d at 1049 n.13. *Bull* itself involved the invocation of equitable recoupment in a refund suit brought by the taxpayer.

[9] The court in *Kolom* devised a different—and equally misguided—theory for distinguishing *O'Brien*, arguing that the Seventh Circuit rejected the equitable recoupment claim for failure to satisfy the "single transaction" requirement and because there was not an identity of interest between O'Brien and the estate (791 F.2d at 768). In fact, the Seventh Circuit specifically stated that it did not find the claim deficient on those grounds (766 F.2d at 1050 & n.16), and it took pains to emphasize that its holding was necessary to maintain "the rule against reopening closed tax years" (*id.* at 1051 n.17).

Court has noted in cautioning against undue expansion of the equitable recoupment remedy, "a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy" (*Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. at 301). Moreover, the decision of the court of appeals effectively nullifies not only the limitations provisions of the Code, but also the detailed mitigation provisions enacted by Congress in 1938 because it makes equitable recoupment identical to mitigation—in that it allows an independent suit otherwise barred by the statute of limitations—but permits its invocation irrespective of whether the situation falls within the circumstances in which Congress determined that mitigation should be permitted.

The court of appeals' departure from fundamental jurisdictional principles is compounded by the clear conflict that it has created with decisions in other circuits. As matters now stand, similarly situated taxpayers will receive disparate treatment depending upon the circuit in which they reside. Taxpayers residing in the Sixth and Ninth Circuits will be able to claim a refund based on inconsistent treatment by the IRS of the same transaction, notwithstanding the fact that the claim is barred by the limitations provisions of Sections 6511 and 7422 of the Code, while taxpayers in the Seventh Circuit—and other circuits that follow the clear import of this Court's precedents—will be unable to maintain such a refund suit because of the statutory bar.

Moreover, the uncertainty that the decision below introduces into the law of equitable recoupment creates serious problems for taxpayers and practitioners in managing tax litigation. In *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943), this Court held that the predecessor of the Tax Court, the Board of Tax Appeals, lacked jurisdiction to consider the taxpayer's equitable recoup-

ment claim, and it is generally believed that this restriction applies to the Tax Court today.[10] Thus, if a taxpayer desires to raise an equitable recoupment claim of the kind approved by this Court in *Bull,* he is well advised not to invoke the jurisdiction of the Tax Court to contest the deficiency (in the tax against which he proposes to offset or recoup the claimed overpayment), but rather to pay the deficiency and bring a timely refund suit in district court or the Claims Court. See Andrews, *supra,* 28 Ariz. L. Rev. at 614-615; Willis, *supra,* 38 Tax Law. at 641-642 & n.130; *O'Brien* v. *United States,* 766 F.2d at 1050 & n.15. The appropriateness of that tax advice, however, is cast into doubt by the decision in this case. Under the court of appeals' view of equitable recoupment, a taxpayer runs no risk by contesting the timely deficiency notice in the Tax Court; he can still raise his equitable recoupment claim by filing an untimely, independent refund suit in district court, as respondent did here.

Thus, the disarray in the circuits poses a dilemma for a taxpayer, or tax practitioner, in an uncommitted circuit who wishes to preserve his right to seek equitable recoupment, but would prefer to litigate in a prepayment forum. Conservative tax advice would counsel that he forgo his right to a prepayment forum in order to preserve his ability to raise equitable recoupment, even if the payment of the deficiency in order to be able to bring a refund suit

[10] The Tax Court is a legislative court of limited jurisdiction that is not invested with the inherent power of an Article III court. The Tax Court has held that it is subject to the rule of *Gooch Milling*. See *Estate of Van Winkle* v. *Commissioner,* 51 T.C. 994, 999-1000 (1969); *Estate of Garber* v. *Commissioner,* 17 T.C.M. (CCH) 646 (1958), aff'd on another issue, 271 F.2d 97 (3d Cir. 1959). See also *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. at 303; 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 115.2.7, at 115-24 to 115-25 (1981).

poses a financial hardship. On the other hand, if the decision below is correct, incurring that financial hardship is unnecessary. It is thus important from the standpoint both of the government and of taxpayers and tax practitioners for this Court to resolve the uncertainty that has been engendered over the scope of equitable recoupment. Accordingly, this Court should grant certiorari and reaffirm that the equitable recoupment doctrine recognized in *Bull* does not authorize the maintenance of an action that is barred by the statute of limitations.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1989

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 88-1079

FRANCES L. DALM, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

Decided and Filed February 8, 1989

Before: NELSON and NORRIS, Circuit Judges; and LIVELY, Senior Circuit Judge.*

LIVELY, Senior Circuit Judge. The doctrine of equitable recoupment holds that when a single transaction or taxable event has been subjected to two taxes on inconsistent legal theories, a taxpayer who meets certain requirements may recover a refund that would be barred otherwise by limitations. *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 299-300 (1946). In the present case the district court granted the government's motions to dismiss the complaint

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* The Honorable Pierce Lively became a Senior Circuit Judge on January 1, 1989.

and for summary judgment upon concluding that the taxpayer was not entitled to a refund of gift taxes by way of recoupment after the statute of limitations for a refund action had expired.

I.

A.

The historic facts are not in dispute. The taxpayer, Frances Dalm, was appointed administratrix of the estate of Harold Schrier in May 1975. The appointment was made at the request of the sole beneficiary of the estate, Clarence Schrier, brother of the decedent. The estate paid the taxpayer $30,000 in 1976 and $7,000 in 1977 as fees. These payments were approved by the probate court. In addition, Clarence Schrier transferred $180,000 to the taxpayer in 1976 and $133,813 in 1977. Clarence Schrier and his wife filed a gift tax return for 1976, showing the $180,000 payment as a gift to the taxpayer. The taxpayer paid the gift tax of $18,675 and interest and penalties of $1,587. No gift tax return was filed with respect to the 1977 transfer of $133,813.

The IRS audited the taxpayer's 1976 and 1977 income tax returns and mailed a notice of deficiency to her and her husband on June 21, 1983. The IRS determined that the two payments from Clarence Schrier were additional administrator's fees and asserted deficiencies of $96,045 in income tax and penalty for 1976 and $74,171 in income tax and penalty for 1977. The taxpayer challenged the deficiency in the Tax Court. She maintained that the two transfers, aggregating $313,813 and representing one-third of the net estate of Harold Schrier, were a gift from Clarence Schrier. The taxpayer had been an employee of Harold Schrier for many years prior to his death. The Tax Court petition stated that Clarence Schrier made the

transfers in order to carry out his brother's intention that the taxpayer share in his estate.

B.

After two days of trial the parties settled the Tax Court case for exactly one-half of the claimed deficiency without penalties. The stipulated decision, entered December 4, 1984, stated that there were deficiences in income taxes due from the taxpayer in the amount of $10,416 for the taxable year 1976 and $70,639 for 1977. The taxpayer paid these deficiences with interest and filed a claim for refund for $20,262, the amount of gift tax and penalty paid in December 1976 and March 1977. When the IRS failed to respond to the claim for refund within six months, the taxpayer filed the present action in district court on September 23, 1985.

In her complaint the taxpayer alleged that the Tax Court decision "determined that a portion of the money said gift tax was paid upon was taxable as income" and that it was inequitable for the government "to collect taxes on the same fund on the mutually exclusive theories of said amount of money being both income and a gift." She sought judgment for "overpaid gift taxes" in the amount of $20,262 with interest. After the government answered, the taxpayer filed a motion for summary judgment. The government then filed a cross-motion in the alternative to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6), or for summary judgment, relying specifically upon the three-year statute of limitations for filing claims for refund contained in Section 6511(a) of the Internal Revenue Code, 26 U.S.C. § 6511(a).

C.

In granting the government's motions, the district court determined that the doctrine of recoupment does not per-

mit a taxpayer to obtain a refund in an independent action after the statute of limitations for claiming a refund has expired. The court held that recoupment is "in the nature of a defense" that must be asserted in some action that has been timely commenced. As an alternative ground for dismissal, the district court found that the allocation of the settlement of the deficiency claim in the Tax Court could lead only to one conclusion—that the previously paid gift tax was taken into account in agreeing on the amount of income tax due. The court concluded that allocation of a small portion of the total agreed deficiency to the year in which the larger amount was received (1976) "was reflective of the tax already paid on that transfer, albeit a gift tax."

II.

On appeal the taxpayer argues that the district court misconstrued the requirement that recoupment be in the nature of a defense and thus erroneously concluded that this was an untimely independent action. She contends that recoupment is not required to be claimed as an actual defense to an action against the taxpayer, but only must be presented in the nature of a defense to a tax illegally collected. She maintains that her action is not barred, because her claim for refund was filed within three years after the IRS claimed a deficiency on the basis of a theory that was inconsistent with her earlier payment of a gift tax on the 1976 transfer. Thus, she asserts, her claim for recoupment was "in the nature of a defense."

The taxpayer also argues that the district court erred in its alternative basis of dismissal. She states that the allocation of the settlement does not give rise to the single inference that the agreement parties took into account the gift tax previously paid on the 1976 transfer. She contends

it is an equally valid inference that the smaller amount was allocated to 1976 to "sweeten the pot" for the taxpayer by reducing the total interest due under the settlement. The taxpayer argues that on this state of the record summary judgment was improper.

The government responds that equitable recoupment is a doctrine of limited application, and that the taxpayer is not within its reach. The government argues that the taxpayer in this case is attempting to use equitable recoupment offensively, rather than defensively. The government maintains that there are only two possible scenarios for the defensive presentation of a claim for recoupment. First, the "doctrine" may only support an independent action for refund of taxes when that action is not barred by the statute of limitations. Second, recoupment may accrue as an offset to the government's timely asserted deficiency determination. The government also argues that the plaintiff failed to demonstrate that she was subjected to double taxation on inconsistent theories, a condition precedent to the application of equitable recoupment. The proceedings in the Tax Court concerned income tax deficiencies for both 1976 and 1977. The taxpayer had paid a gift tax on the 1976 transfer only. It is clear, the government contends, that the allocation of the settlement satisfied the full income tax claimed for 1977, and took into account the previous payment of a gift tax for 1976.

III.

There is no statutory basis for permitting the recovery of a tax overpayment after the statute of limitations has expired. However, the Supreme Court has permitted such recoveries in limited circumstances under the doctrine of equitable recoupment. The first such case was *Bull v. United States*, 295 U.S. 247 (1935). The taxpayer contends

that *Bull* controls the present case and requires judgment in her favor. The government, on the other hand, relies on *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296 (1946), which narrowed the application of equitable recoupment in tax cases. See *Wood v. United States*, 213 F.2d 660, 661 (2d Cir. 1954) ("The gap in statutes of limitation created by the recoupment doctrine in tax cases seemed at one time to be fairly wide. But the gap has been narrowed markedly by McEachern v. Rose, 302 U.S. 56 . . . and Rothensies v. Electric Storage Battery Co., 329 U.S. 296").

A.

In *Bull* the Supreme Court permitted a decedent's estate to recover estate taxes paid in 1921 in a district court action filed in 1930, following rejection of a claim for refund filed in 1928. The decedent was a member of a partnership when he died in February 1920. The executor included the decedent's share of partnership profits from January 1, 1920, to the date of death as an asset of the estate in the estate tax return. The IRS determined in 1921 that the decedent's share of profits for the remainder of 1920 was also an estate asset, and the executor paid additional estate taxes on that amount. However, in 1925 the IRS concluded, during an audit, that the decedent's share of partnership profit for the February-December 1920 period was income to the estate. In July 1925 the IRS made a deficiency determination of income tax for 1920 with no deduction for the estate taxes previously paid on the value of the decedent's partnership interest.

The estate petitioned the Board of Tax Appeals (BTA) for a redetermination in September 1925. After the BTA upheld the deficiency determination, the estate paid the additional income tax and filed a claim for refund in July

1928. When the claim for refund was rejected, the executor filed suit in the Court of Claims in September 1930. In reversing the Court of Claims' denial of the estate's claim the Supreme Court held that the sums received by the estate as the decedent's share of partnership profits after his death were income to the estate, not part of the corpus of the estate. It was error to treat these sums as both assets of the estate and income to the estate under inconsistent theories. When the IRS determined that the profits for February-December 1920 were part of the corpus of the estate in 1921, the executor "had no reason to assume the Commissioner would adjudge the [same sums] income and taxable as such." *Id.* at 258. When the IRS made this latter determination in July 1925 the executor promptly protested that the same item "could not be both corpus and income of the estate." *Id.* It was not until the BTA ruled in the government's favor in April 1928 that the government had taxed the same transaction twice, providing the basis for a recoupment claim. It was then too late to file a claim for refund of the overpayment of estate tax. However, the estate paid the additional income tax and filed a claim for refund, insisting that the sums should have been treated as estate assets rather than income.

In explaining the application of equitable recoupment, the Supreme Court noted that "the usual procedure for the recovery of debts is reversed in the field of taxation." *Id.* at 260. An assessment has the force of a judgment and the burden of proof is shifted to the taxpayer even though the government is seeking to collect a debt and ordinarily would have the burden of proof. When the government began the new proceeding in July 1925 to collect income tax on the money previously taxed as part of the estate, the estate opposed full payment and demanded recoupment to the extent of the amount mistakenly collected as estate tax. Thus, although the estate had the burden of proof, since it

was asserted in response to a deficiency determination, the recoupment claim was "in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action [was] grounded." *Id.* at 262. By its action the government gave the estate a right to a credit or a refund. Although it could not assert this right in an independent action brought by it in 1930, the right had accrued and was available to the estate "since it was actionable and not barred in 1925 when the Government proceeded against [the estate] for the collection of income tax." *Id.* at 263. "Such a defense is never barred by the statute of limitations so long as the main action itself is timely." *Id.* at 262.

B.

The facts in *Rothensies* were quite different from those in *Bull* and the present case. The taxpayer, Electric Storage Battery Co., paid excise taxes on sales of batteries from 1919 to 1926. After it was determined that the sales were not subject to excise taxes, the taxpayer filed suit and obtained refunds in 1935 for taxes paid in 1922-1926, the years that were not barred by the statute of limitations. The government then asserted an income tax deficiency for 1935 upon determining that the refunds were income when received. The taxpayer paid the additional income tax and filed suit for a refund. After first denying that the refunded excise taxes were income, the taxpayer asserted that if they were income it should be able, as against the additional income tax, to recoup the amount of excise taxes paid between 1919 and 1922.

In reversing judgment for the taxpayer, the Supreme Court limited the application of equitable recoupment in tax cases as follows:

> It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

Rothensies, 329 U.S. at 299. The Court reviewed the facts in *Bull* and *Stone v. White*, 301 U.S. 532 (1937), and concluded that those two decisions exemplified the very limited application of recoupment in tax cases. It emphasized that in both instances a single transaction or taxable event had been subjected to two taxes on inconsistent legal theories. This was not the case in *Rothensies*. There the excise taxes were paid on one series of transactions, the sale of batteries. On the other hand, the income taxes were based, not on the sale of batteries, but on the receipt of refunds of the previously paid excise taxes. These refunds were taxable as income in 1935 because the taxpayer had obtained income tax benefits by deducting the excise taxes from its gross income in the years of payment. In *Rothensies* the government did not tax the same transaction under two inconsistent legal theories. It taxed two separate transactions undere separate legal theories that applied to those transactions. *Rothensies* was not a case where the court was required to examine *a transaction* "in all its aspects" and render judgment "that does justice in view of the one transaction as a whole." 329 U.S. at 299. Rather, the taxpayer sought to offset one transaction against another, a result that may not be obtained when refund on the basis of the earlier transaction is barred by the statute of limitations.

IV.

Three criteria must be satisfied for application of equitable recoupment in a tax case. There must be (1) a single transaction or taxable event, (2) that event must be

subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely. *Kolom v. United States*, 791 F.2d 762, 767 (9th Cir. 1986); *cf. Rothensies*, 329 U.S. at 300.

A.

We believe these criteria are satisfied in the present case. There was only one transaction—the payment of $180,000 to the taxpayer in 1976. The taxpayer paid a gift tax on this transaction in 1976 and the IRS did not question this treatment until 1983. When the IRS made its move the taxpayer challenged the deficiency based on the determination of the IRS that the transfer represented income rather than a gift. This issue was not settled until the stipulated decision treated the transfer as income and required the payment of $10,416 as additional income tax for 1976. Just as the executor in *Bull* has no final determination upon which to seek a refund of estate tax until the BTA ruled that the partnership profits were taxable as income of the estate, Mrs. Dalm had no final determination upon which to seek a refund of gift tax in the present case until the stipulated decision settled the question by determining that the 1976 transfer of $180,000 was taxable as income. Only at this point was the single transaction subjected to two taxes on inconsistent legal theories.

When Mrs. Dalm paid the additional 1976 income tax in 1984 she was in the same position as Bull's executor in 1928—she had paid two taxes on a single transaction or taxable event on mutually inconsistent legal theories. Although the taxpayer was the plaintiff in the refund action, her reliance on equitable recoupment was "in the nature of a defense." In addition, her refund action was not barred by the statute of limitations though filed more

than three years after the gift taxes were paid. Her claim for recoupment related to the government's timely deficiency action and was timely as well for purposes of recoupment.

B.

The district court concluded that the taxpayer was precluded from equitable recoupment because she sought it in "an independent lawsuit." The government seeks to support this holding by relying on *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985). After discussing the Supreme Court's holdings in *Bull, Stone* and *Rothensies*, the *O'Brien* court described the limited application of recoupment in tax cases:

> In view of the nature and underlying theory of equitable recoupment, it is clear that the doctrine cannot be used "as an independent ground for reopening years now closed by the statute of limitations." *Evans Trust v. United States*, 462 F.2d 521, 526, 199 Ct.Cl. 98 (1972), and requires the timeliness of the underlying action against which a party seeks to employ recoupment. As the Supreme Court explained in *Bull*, invocation of the doctrine "is never barred by the statute of limitations *so long as the main action itself is timely*." 295 U.S. 262, 55 S.Ct. at 700 (emphasis added).
>
> Attempts by taxpayers to utilize the doctrine to revive an untimely affirmative refund claims, as opposed to offset a timely government claim of deficiency with a barred claim of the taxpayer, have been uniformly rejected.

Id. at 1049.

A careful examination of *O'Brien* reveals that the government has misconstrued the court's reference to "an

independent ground" for reopening barred claims. The government reads this language to mean that a taxpayer may never rely on recoupment in a separate refund action brought after deficiency proceedings are concluded if such an action is barred by the statute of limitations. We construe the reference to "an independent ground" to mean that there must be a timely government claim of deficiency based on an inconsistent theory in order for a taxpayer to maintain an otherwise barred action for recoupment. The missing element in *O'Brien* was a timely claim for deficiency against which the claim for recoupment could be offset. The taxpayer had included a capital gain in his 1975 income tax return using as his cost basis the value of stock reported in his father's estate tax return in 1974. Sometime later the Tax Court entered a stipulated order setting the value per share of the inherited stock at a higher figure. The taxpayer then filed a claim for refund in ~~April~~ 1981, arguing that he had overpaid his income tax in the year of sale by using the lower value per share from the estate tax return in computing the capital gain. The government had never claimed a deficiency with respect to the taxpayer's 1975 income tax return, and it relied on the three-year statute of limitations as a bar to the refund action.

The district court granted a refund, but the court of appeals reversed. What made the taxpayer's action an attempt to use "an independent ground for reopening now closed tax years" was not the fact that limitations would otherwise have barred a refund action. Rather, it was the fact that the government had made no claim for additional taxes. O'Brien's action was truly an attempt to apply recoupment affirmatively in an independent action. The court stated:

> O'Brien untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax

> and does not seek to offset the amount of a properly asserted and timely deficiency.[13]

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[13] A recoupment claim need not be made during an action by the government for payment of a deficiency. It is proper for the taxpayer to pay the entire amount of the properly owed tax and later make a timely refund claim with regard to this properly owed tax raising the defense of equitable recoupment in respect of another time-barred overpayment. See, *e.g.*, *Bull*, 295 U.S. 253, 262-263, 55 S.Ct. at 697, 700-701.

Id. Note 13 makes it clear that Mrs. Dalm's action was not "independent" because of the fact that she waited until the deficiency action in the Tax Court was completed before filing an otherwise barred refund suit.

C.

In other cases relied upon by the government recoupment was denied because one or more of the required elements was missing. In *United States v. Gulf Oil Corp.*, 485 F.2d 331 (3d Cir. 1973), recoupment was denied because two taxes had not been collected on one taxable event on the basis of inconsistent legal theories. Instead, there was a single erroneous collection of a tax, and the taxpayer lost its right to a refund by permitting the statute of limitations to run. The same defect prevented recovery by way of recoupment in *Brigham v. United States,* 470 F.2d 571 (Cl. Ct. 1972), *cert. denied,* 414 U.S. 831 (1973). After the taxpayers had paid taxes at ordinary income tax rates on stock transactions, a change in the law provided a basis for treating the stock sales as capital gains. They sought refunds for barred years on the theory of recoupment. However, two taxes had not been paid or collected.

There was simply an overpayment of taxes on a single transaction, and limitations had run. Recoupment does not permit a taxpayer who has paid only one tax to obtain a refund for barred years because a change in law or policy renders that payment erroneous. We have examined other Court of Claims cases cited by the government, and note that in each at least one element required for the application of recoupment was missing. See *Wilmington Trust Co. v. United States,* 610 F.2d 703 (Cl. Ct. 1979); *Evans Trust v. United States*, 462 F.2d 521 (Cl. Ct. 1972).

• • •

The district court erred in dismissing the taxpayer's recoupment claim on the ground that it was an independent lawsuit seeking a refund for a year for which the statute of limitations had run. *Rothensies* limited the application of recoupment in tax cases by making it clear that one transaction cannot be offset against another to circumvent the statute of limitations. However, *Rothensies* did not disturb the holding in *Bull* that when a single transaction is taxed twice under inconsistent legal theories and the government has collected the second tax in a timely action, the earlier tax can be offset against the later one in an action for refund. The present case, like *Kolom v. United States*, 791 F.2d 762 (9th Cir. 1983), satisfies the requirements for application of the doctrine of equitable recoupment.

V.

We believe it was error, also, to grant the government's motion for summary judgment on the alternative ground that the only plausible explanation for the allocation of the agreed income tax liability between 1976 and 1977 was that the allocation reflected the previously paid gift taxes on the 1976 transfer.

The stipulated decision decided only that there were deficiencies in income taxes for the taxable years 1976 and 1977, and allocated the agreed amount between the two years. The decision did not mention gift taxes. Attorneys who represented the taxpayer and the IRS in the Tax Court proceedings and in the district court filed declarations under oath. One attorney for the government stated that the taxpayer's attorney had proposed that any tax agreed to by the parties should be offset by the previously paid gift tax on the 1976 transfer, but that he had rejected this proposal. From this fact, the government lawyer argued in his memorandum that in settling "the plaintiff resolved all matters in issue with respect to her 1976 and 1977 income tax liability, including the right to recoup the amount of any gift tax that had been paid." In his opposing affidavit the taxpayer's attorney stated that "specific agreement was reached that the settlement would be without prejudice to Petitioner's right to subsequently file a claim for refund for gift taxes inconsistently paid and it was understood that such a claim would be filed immediately thereafter."

The record clearly demonstrates that the taxpayer paid two different taxes on the 1976 transfer of $180,000. What is not clear is whether the agreement to an income tax deficiency of only $10,416 with respect to that transaction included a credit for the $20,262 gift tax previously paid. If it did include such an offset, the two payments were not based on inconsistent legal theories. If this was the case, the earlier payment, though made as a gift tax, was credited against the taxpayer's total 1976 income tax liability in the final settlement and could be treated as an income tax payment. This is the construction the district court put on the settlement. On the other hand, if the total income tax deficiency agreed to by the parties reflected no allowance for the previously paid gift tax and represented

a complete settlement of income taxes for two years with consideration of the prior gift tax payments, then the same transaction has been taxed twice under inconsistent legal theories.

The taxpayer must be given an opportunity upon remand to demonstrate that the income tax settlement was reached without consideration of the previously paid gift tax and that she was, in fact, subjected to two inconsistent taxes on the 1976 transfer from Clarence Schrier. Unless she can establish this fact she will have failed to satisfy a basic requirement for application of equitable recoupment. The record discloses a sharp dispute over the meaning and effect of the agreed disposition of the Tax Court case. Under these circumstances, the government was not, at the motion stage, "entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

The judgment of the district court is reversed, and the case is remanded for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

File No. K85-419-CA4

FRANCES L. DALM, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed Sept. 14, 1987]

OPINION OF THE COURT

HON. ROBERT HOLMES BELL

This is an action commenced by plaintiff, Francis L. Dalm, seeking refund of $20,262.19 in gift taxes, interest and penalties paid to the Internal Revenue Service with respect to a transfer to her of $180,000 in September 1976 by Clarence and Ethel Schrier. These tax amounts were paid by the Schiers in December 1976 and February 1977 and reimbursed by the plaintiff shortly thereafter. It appears further that in the year 1977, the Schriers transferred an additional $133,813 to the plaintiff but made no gift tax return nor paid any gift taxes on this 1977 transfer.

In 1983, the Internal Revenue Service mailed a notice of deficiency to plaintiff for the taxable years 1976 and 1977 asserting that the amounts of $180,000 and $133,813 were income and not gifts. In that same year, plaintiff and her

husband commenced a lawsuit in the United States Tax Court. The Tax Court proceeding resulted in a mid-trial settlement with a determination of income tax deficiencies for the years 1976 and 1977 of $81,055 allocated first to the entire deficiency determined for 1977 and the remaining amount to the taxable year 1976.

Plaintiff's claimed refund in this proceeding is predicated upon the conclusion that the Tax Court settlement determination of income tax deficiency for the transferred monies thereby extinguishes any gift tax consequence on the same monies and necessitates a refund of any gift tax previously paid.

Both parties' competing motions under FRCP 12(b) and 56 underscore that there are no outstanding factual issues requiring resolution.

Because this claim for refund was commenced well after the Internal Revenue Code Section 6511(A) statute of limitations had expired, the gravemen of this case becomes whether Equitable Recoupment may support this independent action for the refund of taxes otherwise barred by the statute of limitations.

The doctrine of Equitable Recoupment was first set forth in *Bull* v. *Uniited States* 295 US 247, (1935) and *Stone* v. *White*, 301 US 532 (1937). In *Minskoff* v. *United States* 490 F2d 1283 (2d Cir 1974) the Court stated at page 1285:

> The theory of the doctrine of equitable recoupment is that one taxable event should not be taxed twice, once on a correct theory and once on an incorrect theory [citations omitted] and that to avoid this happening the statute of limitations will be deemed waived. The doctrine does not allow a litigant to prove any and all mistakes made by him in reporting his tax. Most mistakes must be corrected within the time allowed by the statute of limitations. To succeed in avoiding the

> statutory bar the litigant must show that the opposing party seeks to treat the same item inconsistently as a matter of law.

However this doctrine is not without its limitations. In *Rothensies* v. *Electric Storage Battery Co.*, 329 US 296 (1947) at 299 the Supreme Court stated:

> It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of suit by a plaintiff to be examined in all of its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

The Court then concluded this discussion by stating:

> The application of this general principle to concrete cases in both the cited decisions (sic *Bull* and *Stone*) is instructive as to the limited scope given to recoupment in tax litigation.

While both counsel's briefs cite extensive reference to judicial discussion of Equitable Recoupment no precedent has yet been discovered in which an independent lawsuit, such as this suit, has been maintained for a refund for a year in which the statute of limitations has expired. Defendant's characterization of the doctrine as one in the nature of a defense appears accurate. See *O'Brien* v. *United States*, 766 F.2d 1038 (7th Cir. 1985).

Therefore, This Court must conclude that plaintiff cannot avail herself of the doctrine of Equitable Recoupment and must be bound by the running of the statute of limitations.

There is another reason why plaintiff cannot maintain this lawsuit. She contends that the Tax Court settlement was inclusive of the question of income tax liability and established the transactions of 1976 and 1977 were not gifts subject to gift tax liability.

Factually the liability which the plaintiff consented to as part of the Tax Court settlement was apportioned first to the taxable year 1977 in which no gift tax was reported or paid. In fact the majority of the liability was so applied and only $10,416 of the $81,055 was allocated to the taxable year 1976. This is interesting when the largest transfer occurred in 1976 not 1977. One cannot escape the conclusion that the smaller liability allocated for the year 1976 in light of the larger transfer in 1976 was reflective of the tax already paid on that transfer, albeit a gift tax. No other explanation appears plausible.

Finally, it appears that plaintiff is here seeking to relitigate the tax liability imposed upon the 1976 transfer at least partially by the Tax Court settlement. This cannot be permitted pursuant to section 6512(a) of the Internal Revenue Code. See *Elbert* v. *Johnson* 164 F.2d 421 (2d Cir. 1947).

Accordingly, the defendant's motions for DISMISSAL and SUMMARY JUDGMENT are hereby granted.

Dated: September 10, 1987

/s/ Robert Holmes Bell
ROBERT HOLMES BELL
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 88-1079

FRANCES L. DALM, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

[Entered Feb. 8, 1989]

JUDGMENT

Before: NELSON and NORRIS, Circuit Judges; and LIVELY, Senior Circuit Judge.*

THIS CAUSE came on to be heard on the record from the said district court and was argued by counsel

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this court that the judgment of the said district court in this case be and the same is hereby reversed and the case is remanded for further proceedings consistent with this opinion.

---

* The Honorable Pierce Lively became a Senior Circuit Judge effective January 1, 1989.

No costs taxed.

ENTERED BY ORDER OF THE COURT

LEONARD GREEN, Clerk

/s/ Leonard Green
Clerk

APPENDIX D

Section 6511 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Limitations on credit or refund

(a) Period of limitation on filing claim

Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

(b) Limitation on allowance of credits and refunds

(1) Filing of claim with prescribed period

No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

(2) Limit on amount of credit or refund

(A) Limit where claim filed within 3-year period

If the claim was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the period of any extension of

time for filing the return. If the tax was required to be paid by means of a stamp, the amount of the credit or refund shall not exceed the portion of the tax paid within the 3 years immediately preceding the filing of the claim.

(B) Limit where claim not filed within 3-year period

If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim.

(C) Limit if no claim filed

If no claim was filed, the credit or refund shall not exceed the amount which would be allowable under subparagraph (A) or (B), as the case may be, if claim was filed on the date the credit or refund is allowed.

Section 7422 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Civil actions for refund

(a) No suit prior to filing claim for refund

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

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Supreme Court, U.S.
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JUL 31 1989
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CLERK

(2)

No. 88-1951

In The

Supreme Court of the United States

October Term, 1988

UNITED STATES OF AMERICA,

Petitioner,

v.

FRANCES L. DALM,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Where the Government has asserted a timely deficiency against Taxpayer and, as a result thereof two taxes have been collected on the same taxable event on mutually exclusive theories, does equitable recoupment permit the Taxpayer to maintain a refund suit against the Government to reduce the amount received by the Government?

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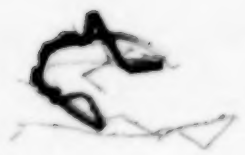
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STATEMENT

Respondent's Statement must be corrected and amplified in the following particulars:

1. The Tax Court trial took place the week of October 15, 1984. The stipulation to the decision was dated October 22, 1984. The Claim for Refund was executed by Frances Dalm on October 29, 1984 and filed November 1, 1984. The dates set forth in the Petition for these events (trial in September, no specific date and claim in November, no specific date) fail to capture the almost immediate nature of the filing of the Claim for Refund, which was pursuant to the specific understanding of the parties that a claim would be filed.

2. The question of the gift tax was specifically left open by the parties. There is no claim in the record by the Government that there was any agreement settling the matter of the gift tax or specifically crediting the amount of the gift tax against the amount paid.

REASONS FOR DENYING THE PETITION

The Petition for a Writ of Certiorari should be denied for the reasons that:

I. The instant case is consistent with this Court's prior decisions.

II. There is no conflict between the Circuits that needs to be resolved.

III. There is no danger of widespread exceptions to the statute of limitations.

IV. Application of the doctrine of equitable recoupment in this case is not contrary to the mitigation provisions of the Internal Revenue Code or the purposes served by statutes of limitation.

I. THE INSTANT CASE IS CONSISTENT WITH THIS COURT'S PRIOR DECISIONS.

The parties agree that the controlling authorities are three Supreme Court cases; namely, *Bull* v *United States*, 295 U.S. 247 (1935), *Stone* v *White*, 301 U.S. 532 (1937) and *Rothensies* v *Electric Storage Battery Co.*, 329 U.S. 296 (1946).

In *Bull*, the business of a Partnership was continued for the balance of the year (1920) in which Mr. Bull died. The post-death profits were included as an asset of the Estate and an Estate tax was paid on that amount in 1921. Subsequently the Commissioner determined that the same post-death profits were income to the Estate and an additional income tax should be paid. The Estate appealed the case to the Board of Tax Appeals which sustained the Commissioner's determination of additional income tax. Thereafter, the Estate paid the tax and instituted a suit for refund in the Court of Claims for the amount ($62,677.44) paid as additional income tax or, in the alternative, for the amount ($47,643.44) paid as estate tax. The suit for refund of income tax paid was not barred by the statute of limitations; however, any suit for refund or credit of Estate tax was untimely and barred by the statute of limitations. The Court of Claims held that the post-death profits were correctly taxed as income but would not offset or credit the erroneous payment of

Estate tax against the correctly paid income tax for the reason that a suit for refund of the Estate tax was barred by the statute of limitations. It was undisputed that the statute of limitations had expired *barring any suit for refund or credit of the overpayment of Estate tax*. (Emphasis added)

This Court, on such facts, held that the Estate was equitably entitled to have credited against the correctly paid income tax, the overpayment of the erroneous Estate tax resulting in a refund to the Estate. In the instant *Dalm* case, as in *Bull*, there was double taxation resulting from inconsistent treatment of the same money and it was too late to file a claim for refund. As observed by this Court in *Bull*, the double taxation involved in such inconsistent treatment resulted in the Government taking more than that to which it was entitled. Retention of the money paid as a gift tax in *Dalm* is against morality and conscience just as retaining the Estate tax in *Bull*, yet, the Government has the temerity to claim that the decision, if permitted to stand would have deleterious consequences for the administration of the tax laws.

In *Stone*, equitable recoupment was applied in favor of the Government to prevent a refund of tax erroneously paid by a Testamentary Trustee, which should have been paid by the Beneficiary where collection from the Beneficiary was barred by the statute of limitations. The principal difference from *Bull* was that the equities favored the Government rather than the Trustee Taxpayer; however, no unjust enrichment resulted to the Government and no injury to the Trustee Taxpayer or the Beneficiary. In *Stone*, application of the doctrine merely resulted in a diminution of the Taxpayer's right to recover, whereas in

Bull, application of the doctrine resulted in a diminution of the Government's recovery. In the instant case there is a diminution in the amount received by the Government which results in no unjust enrichment to the Dalms and no injury to the Government.

The Sixth Circuit in *Dalm* was absolutely correct in stating (page 8a of Appendix to the Petition for a Writ of Certiorari) that: "The facts in *Rothensies* were quite different from those in *Bull* and the present case." Indeed, Special Assistant to the Attorney General, Arnold Raum, who argued the *Rothensies* case, pointedly observed that recovery in that case would not be supported upon equitable principles of recoupment and more importantly that *Bull* was inapplicable because the barred excise taxes did not arise out of the same transaction as the income taxes. While the Taxpayer's suit for refund in *Rothensies* was timely, the claim pleaded as a recoupment was for taxes collected over twenty (20) years before. The basic problem was that there was no single taxable event that had been subjected to two taxes on inconsistent legal theories. *Bull*, *Stone*, the instant *Dalm* case, and *Rothensies* are consistent. All stand for the proposition that the doctrine of equitable recoupment is applicable only where a single taxable event and single transaction has been subjected to two taxes on inconsistent legal theories. Likewise, the doctrine was correctly applied in *Kolom* v *United States* 791 F.2d 769 (9th Cir. 1986); however, in *O'Brien* v *United States*, 766 F.2d 1038 (7th Cir. 1985), *Rothensies* and the other cases cited by the Government, the doctrine correctly should not have been and was not applied.

The Government complains that the decision below if permitted to stand will disrupt the sound administration

of the tax laws. We disagree. It is the government's failure to follow the admonition of this Court in *Bull* that results in deleterious consequences for the administration of the tax laws. The Government's outrageous action in proceeding against a Taxpayer for an income tax deficiency yet at the same time retaining the windfall from taxing the same transaction as a gift causes disruption to the sound administration of the tax laws. The Government has collected two taxes on the same transaction on mutually exclusive theories. In so double dipping it is maximizing dollars rather than following the sound administrative principle of collecting the correct tax, no more and no less. The Government should have allowed a credit for the gift tax paid at the time it proceeded against Frances Dalm for additional income tax.

We do not suggest that the Government should be denied the right to disagree with a Taxpayer by proceeding on an inconsistent theory; however, sound administration as well as fairness would dictate that once it took its position to obtain more money by treating the funds as income then it should give credit for the gift tax paid. No action by a Court was necessary; however, here the Government studiously seeks to perpetuate its unfairness through arbitrary use of power, thus, creating disrespect for and disruption of the sound administration of the tax laws. In short, there is no need for equitable recoupment if the Government plays the game fairly. It follows therefore, that any disruption of the sound administration of the tax laws has been caused by the government's own action in using its power to unfairly maximize dollars and not by the lower Court that remedied the situation.

The Circuit Court quite properly applied the doctrine of equitable recoupment first set forth by this Court with respect to tax laws in *Bull*, thus putting the sound administration of the tax laws back on course.

II. THERE IS NO CONFLICT BETWEEN THE CIRCUITS THAT NEEDS TO BE RESOLVED

The Government's reliance on the decisions in *O'Brien* and *Kolom* for its position that there is a clear conflict between the Circuits is misplaced. In *O'Brien*, two separate taxable events occurred. As stated in *Kolom*, 768 fn 12:

> "Property for estate tax purposes was undervalued and the IRS asserted a deficiency for the undervaluation. Had the correct value been used to report the gain, the taxpayer would have paid less tax. After the IRS changed the value of the property in the estate, the first transaction, taxpayers tried to claim refund of the tax paid as gain on the sale of the property, the second transaction."

The Government wrongly implies that the "main action" which must be timely is the Taxpayer's action. In *O'Brien*, it is clear that the "main action" that had to be timely was the government's assertion of a deficiency and not the Taxpayer's claim for refund. The *O'Brien* Court recognized the distinction in stating at page 1049 that the doctrine will "permit a taxpayer to recoup an erroneously paid tax, the refund of which is time barred, against a timely and correctly asserted deficiency by the government." In fact, later on in its opinion, the Court set forth an instance in which equitable recoupment *perhaps could* have applied as follows:

> "The estate potentially could have recouped Michael O'Brien's income tax overpayment against the excess estate tax owed by the estate *resulting from the Tax Court's stipulated order.* Assertion of the doctrine would be proper because the 'main action,' the government's deficiency suit, would be timely." (emphasis added)

In *O'Brien* the payor was a shareholder of a corporation who sold its stock using an improper lower basis because an Estate improperly had undervalued the stock. Undervaluation of the stock also would benefit the shareholder. Despite the Government's assertion in its Petition (fn 9 at pg 16) that the *O'Brien* Court did not reach its holding because of the lack of identity of the two taxpayers it should be observed that the Court emphasized the difference in identity of interest between the payor of the erroneous overpayment and the recipient of the recoupment concluding that O'Brien was not in a position to invoke the doctrine of equitable recoupment. Lack of identity seemed extremely material to the *O'Brien* Court. Also such footnote, because of its grammatical imprecision, might be read to suggest the *O'Brien* court did not consider the "single transaction" test. In fact, *Rothensies* is specifically cited on the point.

As expressed by many learned Justices, including Holmes, words are not plain in themselves. *Dalm* is not *an independent suit* as the Seventh Circuit in *O'Brien* defined one because the deficiency for additional income tax asserted by the Government against Frances Dalm was timely. In *O'Brien*, at page 1049, it is stated "O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax ***and does not seek to offset the amount of a properly asserted and***

***timely deficiency.*"** (emphasis added) Contrary to the government's assertion that the lack of a properly asserted deficiency played no role in the *O'Brien* Court's decision, the above sentence emphasized by bold type appears immediately before the Court's conclusion that *"This Court sees no grounds for extending the doctrine and the Plaintiff offers none."* The *Dalm* suit, likewise, because recoupment is sought by the proper person against a properly owed tax paid by the same Taxpayer, pursuant to the stipulated Order of the Tax Court after the government's timely assertion of a deficiency, is not an independent action as the Seventh Circuit uses the term. Accordingly, there is no conflict between the circuits that needs to be resolved. Furthermore, the Government's position that the *Kolom* case conflicts with the 1985 Seventh Circuit decision in *O'Brien* is inconsistent with the Seventh Circuit's favorable citation of *Kolom* in its 1988 decision in *First Chicago Corporation* v *Commissioner of Internal Revenue*, 842 F.2d 180 (7th Cir. 1988). The Government apparently saw no conflict between *Kolom* and *O'Brien* in 1988 when it cited *Kolom* to the same Circuit that decided *O'Brien*. Did the conflict just arise in 1989? Indeed, such inconsistency raises a question of credibility.

III. THERE IS NO DANGER OF WIDESPREAD EXCEPTIONS TO THE STATUTE OF LIMITATIONS

From the inception of this action, the Government has maintained that applying equitable encoupment in this case would subvert the statute of limitations and the mitigation provisions as provided for by Congress. That is not the case, and were it the case, it would be a sorry

commentary on the administration of the tax laws. Far from opening the floodgates, the doctrine would never be applicable at all if the Government did not seek to retain unjust windfalls. Fortunately, the unfair windfall taxation of the identical transaction on two mutually exclusive theories is relatively rare. Section IV C of the Sixth Circuit's opinion, examines all of the cases cited by the Government and is able to find *no other instance* in which two taxes are paid on the identical transaction. In fact, far from providing a gaping loophole in the statute of limitations, the doctrine of equitable recoupment provides a pressure release valve in those rare cases when the statute of limitations is used by one side or the other to have it both ways, the Government to collect two taxes or the Taxpayer to pay none. The deficiency in income tax for 1976 and 1977 was not asserted against the Dalms until 1983, long after the statute of limitations had expired on seeking a refund for the gift tax. The fundamental unfairness of expecting the taxpayer to do so is noted in *Kolom* at 767 (fn 11).

> "Kolom's minimum tax liability for 1972 was not finally determined until 1981. Thus, Kolom was effectively precluded from asserting a timely claim for refund. Although Kolom had until April 15, 1977 to file a timely claim for refund under IRC Section 6511, to require him to do so would have placed him in the difficult position of requesting refund of a tax he asserted was correctly paid."

None of the three cases cited by the Government, *Ellard* v *United States*, 228 Ct. Cl. 815 (1981), *Brigham* v *United States*, 470 F.2d 571, 577 (Ct. Cl. 1972), cert. denied, 414 U.S. 831 (1973) and *Evans Trust* v *United States*, 462

F.2d 521, 525-526 (Ct. Cl. 1972) deal with two taxes being collected on the same transaction.

In *Ellard* a partner sold diesel fuel to a partnership and then the partnership sold the same fuel to customers for highway use. The Partnership attempted to recoup excise taxes erroneously paid on diesel fuel when it was sold to the partnership against the taxes rightly owed by the partnership when it sold the fuel for highway use. As noted by the court, this case involved two separate transactions (and two separate taxable events).

In *Brigham*, the taxpayers sought to recoup tax paid at ordinary income rates on the installment sale payments received in 1958 through 1961 after the Internal Revenue Service had acknowledged the installments received in 1962 were to be taxed as a capital gain. This case also involved different transactions and in fact, different tax years.

Evans Trust is even further afield. As no deficiency was determined to exist in estate tax, only income tax was collected. There may have been only one transaction but, properly, there was only one tax.

The mitigation provisions deal with a number of specified instances, but would not have helped the taxpayer in *Bull*. The mitigation provisions are limited to inconsistent payments of the same kind of tax (See Reg. Section 1311(a) 2(b)). Paying both estate and income or gift and income tax on the same transaction is not covered. There was no need for Congress to add such a provision to the tax law. It already existed in the doctrine of equitable recoupment.

No uncertainty will exist in the law as a result of *Dalm*. Each taxable event is to be taxed once. This is by no means a revolutionary principle. Only double taxation on inconsistent theories of the same taxable event is correctable pursuant to the doctrine of equitable recoupment. Judge Learned Hand cogently stated the principle in *Elbert* v *Johnson*, 164 F.2d 421, 424-425 (2d Cir. 1947) as follows:

> " . . . If the transaction is susceptible of two interpretations, and the Taxpayer has paid a tax which was required by the interpretation he puts upon it, he does not forfeit the right to a refund of that tax because the statute of limitations has run against him before the courts have finally decided that his interpretation was wrong; *the statute is tolled*. (emphasis supplied)"

IV. APPLICATION OF THE DOCTRINE OF EQUITABLE RECOUPMENT IN THIS CASE IS NOT CONTRARY TO THE MITIGATION PROVISIONS OF THE INTERNAL REVENUE CODE OR THE PURPOSES SERVED BY STATUTES OF LIMITATION.

In its Petition for a Writ of Certiorari, the Government has cited Andrews, "Modern-Day Equitable Recoupment and the Two Tax Effect:" Avoidance of the statutes of limitation in Federal Tax Controversies, 28 Ariz. L. Rev. 595 (1986) in opposition to *Kolom*. In fact, the principal thrust of the article is that the doctrine is alive and well, has a valid and legitimate value to both the Government and Taxpayers and indeed should not be restricted. Unfortunately, the article did not analyze *Kolom* in any great detail; however, *Kolom* was cited

favorably on several points (see, for instance fn. 147, page 620).

Further, in the article, two of the Government's arguments are completely refuted. For instance, with regard to the mitigation provisions, it is said:

> "Congress apparently did not envision them as entirely displacing these judicial doctrines, but rather serving as a supplement to them." Andrews, p. 621, citing at fn150. S.Rep. No. 1567, 75th Cong., 3d Sess 49 (1938)

It is further pointed out that the "statutory mitigation provisions deal solely with income taxes." Ibid.

Accordingly, it is clear that the statutory mitigation provisions, IRC Sections 1311-1314, are entirely separate from and unrelated to the case at bar.

In addition, the article closed with a lengthy analysis of the reasons and philosophy behind statutes of limitation. Andrews at 644-647. The rationale of statutes of limitation as they relate to equitable recoupment is set forth at 645-646:

> "Given the foregoing reasons for the existence of tax limitation statutes, particularly that of preventing the litigation of stale claims, their relationship to the single transaction element of equitable recoupment and to the automatic facet of *Bull*, quickly becomes apparent. The Supreme Court seemingly imposed the single transaction element of the doctrine because it helps avoid the very staleness problem against which limitations are principally directed. Where a single item, transaction or taxable event is under scrutiny in connection with the open claims of one party, the facts of such transaction relating to the barred claim of the other party are, almost by definition, the same or related and substantially known. Consequently,

> the single transaction concept helps ensure a minimal staleness problem. Obviously in such a situation the negation of a statute of limitation by the application of equitable recoupment is more palatable.
>
> The same may be said of the automatic facet of *Bull* which is also present in *Herring-Bowcut* and *Wilmington Trust*. In each of these cases the determination of the open claim leaves little or no factual issue with respect to the barred claim, and, hence, no real problem of staleness exists. Unlike the justifiable fear voiced by the Court in *Electric Storage Battery*, here no search with respect to the barred claim is either invited or necessary as it is already automatically known."

The "automatic feature" of *Bull* is described at 644.

> "Another obvious, but unemphasized, feature of *Bull*, however, was the automatic nature of its conclusion with respect to the barred estate tax refund claim of the taxpayer once the Court made its determination as to the open income tax claim of the government (being litigated in the setting of the taxpayer's income tax refund suit). That is, once the Court determined that the post-death partnership profits were property subject to the income tax, it was pretty much automatic, in the circumstances of that case, that such profits had been improperly subjected to the estate tax."

With respect to the Government's claim (pg 16 of its Petition) that the decision below would undermine the goals of finality and repose, the following language at page 646 is particularly appropriate:

> "The concept of final repose also does not seem to be overwhelming importance where the claim of one party may only be inchoate or not even exist until the determination concerning the open claim has occurred, at which time the former may already be barred."

In *Dalm* as in *Bull*, nothing is left to be determined on stale evidence. If it was a gift, it was not income. If it was income, it was not a gift. The Tax Court's decision gave rise to a circumstance (gift tax collected on income) that automatically required a refund.

CONCLUSION

The *Dalm* case has been rightly decided. Therefore, the Petition For Writ of Certiorari should be denied.

Respecfully submitted,

Robert B. Pierce
Paul T. Mengel

Supreme Court, U.S.
FILED
AUG 21 1989
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 88-1951

In the Supreme Court of the United States

OCTOBER TERM, 1989

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

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1. It is black letter law that the United States may not be sued except as it expressly consents to suit. See, *e.g.*, *United States* v. *Testan*, 424 U.S. 392, 399 (1976); *United States* v. *Sherwood*, 312 U.S. 584, 586 (1941). An action that does not comply with the conditions that Congress has attached to its waiver of sovereign immunity may not be maintained. And it is equally clear that a statute of limitations "constitutes a condition on the waiver of sovereign immunity" and, as such, "define[s] the extent of the court's jurisdiction" over a claim. *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986); see also *Block* v. *North Dakota*, 461 U.S. 273, 287 (1983); *United States* v. *Kubrick*, 444 U.S. 111, 117-118 (1979). Therefore, failure to satisfy the limitations period established by Congress is

an absolute bar to a lawsuit. This case is a suit by a taxpayer to recover money from the government on the ground that she overpaid her taxes. It is undisputed that this action was not filed within the limitations period established by Congress for such tax refund actions. Accordingly, under fundamental principles of jurisdiction and sovereign immunity, the suit may not be maintained. Neither the court of appeals nor respondent has explained why this case is not governed by these principles.

Respondent argues, and the court of appeals held, that this lawsuit is permitted under the doctrine of equitable recoupment recognized by this Court in *Bull* v. *United States,* 295 U.S. 247 (1935). As we explained in our petition (at 6-8), however, the Court in *Bull* made clear that the doctrine is consistent with principles of sovereign immunity and with the statutory limits on jurisdiction in that it does not permit an independent suit that is barred by the statute of limitations. Rather, the doctrine of equitable recoupment simply allows a party to raise a recoupment claim as an offset in an action regarding a related tax controversy that has been brought in accordance with the jurisdictional prerequisites established by Congress—specifically, "so long as the main action itself is timely" (295 U.S. at 262). Because respondent is not seeking to recoup her gift tax payments as an offset against another tax liability being litigated in a timely action, *Bull* is not applicable to this case.

Respondent completely ignores this crucial limitation on equitable recoupment and the related discussion in the petition. Instead, respondent simply maintains that she is free to bring this lawsuit to recover money from the United States, despite the conceded absence of congressional consent, because, "as in *Bull,* there was double taxation resulting from inconsistent treatment of the same money and it was too late to file a claim for refund" (Br.

in Opp. 3). Respondent proceeds to state that "[r]etention of the money paid as a gift tax in [the instant case] is against morality and conscience just as retaining the Estate tax in *Bull*" (*ibid.*). The very portion of *Bull* paraphrased by respondent demonstrates the fundamental error of her rudimentary effort to equate the two cases. As we noted in our petition (at 7), the Court in *Bull* made clear that, even though retention of the estate tax overpayment could be viewed as "against morality and conscience" (295 U.S. at 260), the taxpayer there could not seek a refund of that overpayment once the limitations period had expired, and he would have had no judicial redress but for the opportunity to raise the claim for recoupment in the timely filed income tax refund suit. Respondent here, having failed to file a timely gift tax refund suit or to raise a recoupment claim in a timely suit for refund of the income tax (see pages 4-5, *infra*), no longer has any permissible avenue for redress in court. As *Bull* and its progeny make clear, she is not authorized to sue the United States in defiance of the conditions established by Congress.

2. The thrust of respondent's argument is that she must be allowed to sue for a refund of the gift tax that she paid for 1976 because it would be inequitable to permit the IRS to retain those funds (see Br. in Opp. 4-6). As this Court noted in *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296, 302 (1946), however, the inevitable price of enforcing statutes of limitations is the possibility of inequities in individual cases. Respondent's position is no different from that of any other taxpayer who has overpaid his taxes, but whose refund claim is barred by the statute of limitations. If the unfairness of that predicament is sufficient reason to permit an untimely refund suit, statutes of limitations are meaningless. They would bar only unmeritorious claims—which, of course, can be distinguished

from those that are meritorious only by litigating the merits in each case.

Respondent also argues (Br. in Opp. 5) that her lawsuit should be allowed to proceed because the government acted "arbitrar[ily]" and "outrageous[ly]" in failing to refund the gift tax when it proceeded against respondent for the income tax due. These accusations are unfounded. Under Section 6402(a) of the Internal Revenue Code, the IRS is authorized to make refunds or credits in respect of overpayments of tax "within the applicable period of limitations," and therefore it lacked authority to refund the gift tax paid by respondent here.[1] In any event, even if there were grounds for criticizing the IRS's conduct in this case, that would not establish a basis for jurisdiction of an action against the United States that fails to satisfy the applicable statute of limitations.

Respondent also notes (Br. in Opp. 9) that the income tax deficiencies were not asserted until the time to seek

[1] The IRS could have allowed a credit for the gift tax payment if respondent had made a claim for application of that payment against the income tax deficiency. See Rev. Rul. 71-56, 1971-1 C.B. 404. Respondent made no such claim, and instead elected to contest the income tax deficiency in the Tax Court. It is not clear whether she in any event received a credit for the gift tax payment in the course of the Tax Court proceedings. The government did not collect the full amount of the asserted income tax deficiency. Instead, the income tax litigation was settled for a lower amount, and the total amount of tax collected by the government (both income and gift tax) was less than the amount of the income tax deficiency. The district court observed that the income tax settlement appeared to be designed to credit respondent for the gift tax that she paid (Pet. App. 20a). While the court of appeals held that there was an insufficient factual basis for treating the income tax settlement as providing full credit for the gift tax payment (*id.* at 14a-16a), there is similarly no basis for concluding on this record that the settlement did not provide such a credit. Thus, respondent's assumption that she has been subjected to double taxation (see Br. in Opp. 5) is not necessarily correct.

a gift tax refund had expired, and argues that it therefore is not realistic or fair to expect her to have filed a timely gift tax refund action. The practical problem posed by such a situation, however, is alleviated by the equitable recoupment doctrine discussed in *Bull* and by the mitigation provisions enacted by Congress in 1938 (see 26 U.S.C. 1311-1314; Pet. 10), which are an express exception to the generally applicable statute of limitations. As respondent recognizes (Br. in Opp. 12), however, Congress did not choose to permit mitigation in the circumstances presented here. And, as we noted in our petition (at 14), respondent did not take the steps necessary to seek to recoup her gift tax payment under *Bull* by claiming it as an offset in a timely filed action for an income tax refund. The course of action chosen by respondent—filing an independent action against the United States that is clearly barred by the statute of limitations—is not permissible. The court of appeals has no authority to create a new method for respondent to recover an overpayment of tax—outside the established framework of a timely refund suit, an equitable recoupment claim in a timely filed suit, or a suit allowed by the mitigation provisions. As this Court has stated (*Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. at 303), "[i]f there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them."

3. In our petition, we explained (at 11-16) that the decision below squarely conflicts with decisions of the Seventh Circuit and the Court of Claims that rejected efforts to invoke equitable recoupment as a basis for an independent time-barred suit against the United States to recover an alleged overpayment of tax. We further explained (at 17-19) why resolution of this conflict is necessary to eliminate uncertainty for taxpayers and practi-

tioners in managing their tax litigation. Respondent does not effectively rebut these points.

The rationale for the Seventh Circuit's decision in *O'Brien* v. *United States,* 766 F.2d 1038 (1985), is clearly stated in the opinion and is flatly inconsistent with the decision below: "[T]he doctrine [of equitable recoupment] cannot be used 'as an independent ground for reopening years now closed by the statute of limitations,' *Evans Trust v. United States,* 462 F.2d 521, 526, 199 Ct. Cl. 98 (1972), and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (766 F.2d at 1049). In this case, respondent is not seeking to recoup her gift tax as an offset against another tax liability; the instant suit against the United States concerns only the time-barred gift tax issue. Thus, it is clear that the Seventh Circuit (and the Federal Circuit (see Pet. 11, 14)) would not allow the suit.[2]

Nor is there substance to respondent's assertion (Br. in Opp. 7-8) that her suit is not an "independent suit" within the meaning of *O'Brien* because the government filed a timely notice of income tax deficiency in this case. There is no reason to believe that the Seventh Circuit used the word "independent" in a manner completely divorced from the

[2] Respondent's assertion (Br. in Opp. 8) that the Seventh Circuit has abandoned *O'Brien,* or that the decision can be reconciled with the decision below, because the Seventh Circuit cited *Kolom* v. *United States,* 791 F.2d 762 (9th Cir. 1986), in *First Chicago Corp.* v. *Commissioner,* 842 F.2d 180, 182 (7th Cir. 1988), is plainly without merit. The referenced citation merely notes *Kolom* as a case where the taxpayer was permitted to invoke equitable recoupment; the court in *First Chicago,* which did not involve an equitable recoupment issue, did not consider the correctness of *Kolom* and certainly did not approve the decision. Respondent's further assertion that the government relied upon—or even cited—*Kolom* in its brief in *First Chicago* is simply incorrect, and the government has never suggested that *Kolom* was correctly decided.

ordinary meaning of the word. Moreover, as we explained in our petition (at 15), respondent's related assertion that the result in *O'Brien* turned on the absence of a deficiency notice in that case is refuted by common sense, by this Court's decision in *Stone* v. *White,* 301 U.S. 532 (1937), and by the opinion in *O'Brien* itself, which notes that the taxpayer there could have raised a recoupment claim in a timely filed estate tax refund action.[3] Rather, O'Brien's claim failed because he did not raise it as an offset in a timely-filed action, but instead, like respondent, "assert[ed] recoupment affirmatively" (766 F.2d at 1049) by filing an independent action against the United States that did not meet the conditions imposed by Congress. Accordingly, there is a square conflict in the circuits that requires resolution by this Court.[4]

[3] And, as we also explained in our petition (at 16 n.9), respondent's assertion that *O'Brien* rested either on a failure to meet the "single transaction" requirement or on a lack of identity of interest between O'Brien and the estate cannot be maintained in the face of the Seventh Circuit's explicit statements that it did not find O'Brien's claim deficient on those grounds (766 F.2d at 1050 & n.16).

[4] Respondent's reliance (Br. in Opp. 11) on *Elbert* v. *Johnson,* 164 F.2d 421 (2d Cir. 1947), is misplaced. In that case, the taxpayers had sought to recover a prior gift tax payment by invoking equitable recoupment in a Tax Court proceeding concerning income tax liability arising out of the same transaction. The Tax Court determined that it lacked jurisdiction to award recoupment. See Pet. 17-18 & n.10; *Commissioner* v. *Gooch Milling & Elevator Co.,* 320 U.S. 418 (1943). The taxpayers then sought to raise the recoupment claim by filing an income tax refund action, and the court of appeals held the action barred by Section 322(c) of the 1939 Code, which embodied the general rule prohibiting a refund action with respect to a tax that was the subject of a prior Tax Court proceeding. See 26 U.S.C. 6512(a). In its opinion, the court noted that it assumed that the taxpayers could have raised an equitable recoupment claim in a timely-filed suit for refund of the income tax liability (if they had not first resorted to the Tax Court). Thus, the holding and opinion in *Elbert* are both fully

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1989

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consistent with *Bull*. The passage quoted by respondent is taken from a separate opinion concurring in the result, which also agreed that the taxpayers could not maintain their independent action for equitable recoupment. The particular passage emphasized by respondent is thus dictum even within the context of the concurring opinion; moreover, it is incorrect. There is no support for the proposition that the statute of limitations is "tolled" while a taxpayer litigates his version of a transaction to a final resolution. To the contrary, this Court stated in *Bull* that inconsistent treatment of a particular transaction "cannot avail to toll the statute of limitations" (295 U.S. at 259).

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No. 88-1951 (4)

In the Supreme Court of the United States

OCTOBER TERM, 1989

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether the doctrine of equitable recoupment provides a basis for jurisdiction over a taxpayer's suit against the United States for a refund of an erroneous tax payment, when that suit is otherwise barred as untimely by Sections 7422 and 6511 of the Internal Revenue Code.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 867 F.2d 305. The opinion of the district court (Pet. App. 17a-20a) is not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 21a-22a) was entered on February 8, 1989. On May 2, 1989, Justice Scalia extended the time to petition for a writ of certiorari to and including June 8, 1989. The petition was filed on June 5, 1989, and was granted on October 2, 1989. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 6511 and 7422 of the Internal Revenue Code (26 U.S.C.) are set forth in a statutory appendix (App., *infra*, 1a).

STATEMENT

1. Respondent, who had been a long-time employee of Harold Schrier, was appointed administratrix of his estate in May 1975 at the request of Clarence Schrier, the decedent's brother and the sole beneficiary of the estate. The estate paid respondent fees of $30,000 in 1976 and $7,000 in 1977, which were approved by the probate court. Respondent also received from Clarence Schrier a payment of $180,000 in 1976 and a payment of $133,813 in 1977. In December 1976, Clarence Schrier and his wife filed a gift tax return reporting the $180,000 transfer in that year as a gift to respondent, and respondent paid the reported gift tax of $18,675. The Schriers subsequently were assessed $1,587 in interest and penalties with respect to the 1976 transfer, which they paid in March 1977 and for which respondent reimbursed them. No gift tax return was filed respecting the 1977 transfer. Pet. App. 2a, 17a; C.A. App. 79.

On audit, the Internal Revenue Service (IRS) determined that the payments made by Clarence Schrier to respondent represented additional fees for her services as administratrix of the estate, which should have been reported as income.[1] The IRS accordingly asserted deficiencies in respondent's income tax of

[1] This determination was based upon an agreement regarding the distribution of the estate that was executed in 1975 by respondent and Clarence Schrier. See C.A. App. 58.

$91,471 for 1976 and $70,639 for 1977, together with additions to tax under I.R.C. § 6653(a) of $4,574 and $3,532 for those years, respectively. Respondent petitioned the Tax Court for a redetermination of the asserted deficiencies, contending that the transfers of $180,000 and $133,813 were gifts from Clarence Schrier intended to carry out his brother's intention that respondent share in the estate. After two days of trial, the parties negotiated a settlement of the Tax Court case for one half the total amount of the asserted deficiencies (excluding penalties), and they agreed to a stipulated decision that respondent owed income tax deficiencies of $10,416 for 1976 and $70,639 for 1977. Pet. App. 2a-3a, 17a-18a.

2. In November 1984, promptly after agreeing to settlement of her Tax Court case, respondent filed an administrative claim for refund of the $20,262 in gift tax, interest, and penalties paid with respect to the $180,000 transferred to her in 1976. Pet. App. 3a. This claim was untimely, however, since it was filed almost five years after the expiration of the three-year limitations period provided in Section 6511 of the Internal Revenue Code[2] for the recovery of overpayments of gift, estate, or income tax. When the IRS failed to act on the refund claim within six months, respondent brought this suit for refund of "overpaid gift taxes" (C.A. App. 5) in the United States District Court for the Western District of Michigan.

The district court granted the government's motion to dismiss for lack of jurisdiction (Pet. App. 17a-20a). After noting that the suit unquestionably was untimely under the applicable statute of limitations,

[2] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

the court rejected respondent's contention that the suit could be maintained under the doctrine of equitable recoupment set forth in *Bull* v. *United States*, 295 U.S. 247 (1935). Citing this Court's decision in *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296 (1946), and the Seventh Circuit's decision in *O'Brien* v. *United States*, 766 F.2d 1038 (1985), the district court concluded that there was no authority for using equitable recoupment as the jurisdictional basis for "an independent lawsuit, such as this suit, * * * maintained for a refund for a year in which the statute of limitations has expired" (Pet. App. 19a).[3]

3. The court of appeals reversed (Pet. App. 1a-16a). The court held that the doctrine of equitable recoupment allowed respondent to bring the untimely suit because the payment of the gift tax was inconsistent with the treatment of the transfers in the Tax Court settlement as fees for services rendered. The court of appeals characterized this Court's decision in *Rothensies* v. *Electric Storage Battery Co.*, *supra*, from which the district court had quoted, as narrowing the application of the equitable recoupment doctrine established in *Bull* v. *United States*, *supra* (see Pet. App. 6a), but stated that "[t]he facts in *Rothensies* were quite different from those in *Bull* and the present case" (*id.* at 8a).

Citing the Ninth Circuit's decision in *Kolom* v. *United States*, 791 F.2d 762 (1986), the court enu-

[3] The district court also observed that the Tax Court settlement appeared designed to reflect the prior payment of gift tax, and therefore that respondent in any event would not be entitled to a refund of that tax (Pet. App. 20a). The court also stated that, pursuant to Section 6512(a) of the Code, commencement of the Tax Court proceeding for 1976 barred this suit for refund of 1976 taxes (*ibid.*).

merated three prerequisites to the application of equitable recoupment (Pet. App. 9a-10a): "There must be (1) a single transaction or taxable event, (2) that event must be subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely." The court then held that these three requirements were satisfied in this case. With respect to the third criterion, the court stated that, "[a]lthough the taxpayer was the plaintiff in the refund action, her reliance on equitable recoupment was "in the nature of a defense'" (*id.* at 10a). The court concluded (*id.* at 10a-11a): "[Respondent's] refund action was not barred by the statute of limitations though filed more than three years after the gift taxes were paid. Her claim for recoupment related to the government's timely deficiency action and was timely as well for purposes of recoupment." In so holding, the court summarized the holding of this Court in *Bull* v. *United States*, *supra*, as follows (Pet. App. 14a): "[W]hen a single transaction is taxed twice under inconsistent legal theories and the government has collected the second tax in a timely action, the earlier tax can be offset against the later one in an action for refund ."[4]

SUMMARY OF ARGUMENT

A. It is fundamental that the United States, as sovereign, is immune from suit, and therefore may be

[4] The court of appeals also held that the district court could not grant summary judgment for the government on the alternative ground that the Tax Court settlement for 1976 took the gift tax overpayment into account (Pet. App. 14a-16a). The court of appeals remanded for fact finding on the intent of the parties to the Tax Court settlement (*id.* at 16a).

sued only upon satisfaction of the conditions under which Congress has consented to suit. A statute of limitations is "a condition on the waiver of sovereign immunity," and, as such, "define[s] the extent of the court's jurisdiction" over an action governed by that limitations period. *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986). Because respondent concededly did not file a timely claim for refund of gift taxes, it is undisputed that this suit is untimely under the general provisions governing the conditions under which tax refund suits may be brought against the United States. See I.R.C. §§ 6511(a), 7422. And it is similarly undisputed that the mitigation provisions (I.R.C. §§ 1311-1314), in which Congress excepted from the general limitations provisions certain suits involving claims of inconsistent treatment, do not apply in these circumstances. Thus, as the court of appeals acknowledged (Pet. App. 5a), there is no statutory basis for district court jurisdiction over this lawsuit.

B. The doctrine of equitable recoupment approved by this Court in *Bull* v. *United States*, 295 U.S. 247 (1935), has no application here. As its name implies, this judicial doctrine involves the recoupment of a tax overpayment by means of an adjustment to another tax liability. Specifically, it permits a refund claim that would be time-barred if brought independently to be applied to reduce another related tax liability that is being litigated in a timely-filed proceeding. Thus, the doctrine does not operate to confer upon a court jurisdiction over a lawsuit that is barred by the statute of limitations; rather, it is only because the court properly has jurisdiction over the timely claim that it is empowered, in an appropriate case, to offset or credit a prior overpayment of tax whose direct refund is barred by the statute of limitations. This constraint on equitable recoupment has been repeatedly expressed by this Court, which has explicitly stated that equitable recoupment "cannot avail to toll the statute of limitations" (*id.* at 259), but rather can be raised only "in the nature of a defense * * * so long as the main action itself is timely" (*id.* at 262). See also *Stone* v. *White*, 301 U.S. 532, 539 (1937).

Thus, the court of appeals' holding that equitable recoupment can give a court jurisdiction over an independent refund suit against the United States that is barred by the statute of limitations is flawed in several respects. It contradicts the restrictions on the equitable recoupment doctrine that have been emphasized by this Court. It violates fundamental principles of sovereign immunity by permitting a suit against the United States without satisfying the prerequisites established by Congress to such a suit. It also does not comport with the detailed mitigation provisions established by Congress that specifically permit time-barred refund suits in certain specified circumstances of inconsistent tax treatment. If the court of appeals' view of equitable recoupment were correct, it would have been unnecessary for Congress to enact the mitigation remedy. The all-encompassing availability of recoupment would also effectively thwart Congress's considered decision to restrict, to the circumstances carefully defined in the mitigation provisions, the right to bring a refund suit that does not comply with the generally applicable statute of limitations.

The effect of the decision below is to nullify the statute of limitations for all cases in which a taxpayer can argue that he has been subjected to inconsistent tax treatment. But such a taxpayer has no stronger claim to refund than any other taxpayer who has overpaid his taxes, but whose refund claim

is barred by the statute of limitations. Respondent failed to take the proper steps to claim a gift tax refund in a timely fashion, and, like any other taxpayer, she has no right to have the district court exercise jurisdiction over a suit barred by the applicable statute of limitations. As this Court held in rejecting another proposed extension of the applicability of equitable recoupment (*Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296, 303 (1946)), "[i]f there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them."

ARGUMENT

THE DOCTRINE OF EQUITABLE RECOUPMENT DOES NOT PROVIDE A BASIS FOR JURISDICTION OVER AN INDEPENDENT SUIT AGAINST THE UNITED STATES FOR A TAX REFUND, WHEN THAT SUIT IS BARRED BY THE STATUTE OF LIMITATIONS

A. Respondent's Refund Suit Did Not Satisfy The Conditions Under Which Congress Conferred Jurisdiction Upon The Courts To Entertain Such Suits Against The United States

It is a fundamental principle of federal jurisprudence that "the United States, as sovereign, 'is immune from suit, save as it consents to be sued . . . and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit.'" *United States* v. *Testan*, 424 U.S. 392, 399 (1976), quoting *United States* v. *Sherwood*, 312 U.S. 584, 586 (1941); see also *United States* v. *Mitchell*, 445 U.S. 535, 538 (1980). It is equally clear that, when Congress establishes a statute of limitations for suits against the United States, "the limitations provision constitutes a condition on the waiver of sovereign immunity," and, as such, "define[s] the extent of the court's jurisdiction" over such an action. *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986); see also *Block* v. *North Dakota*, 461 U.S. 273, 287 (1983). It is the responsibility of Congress to decide when to waive the sovereign immunity of the United States, and hence "'this Court has long decided that limitations and conditions upon which the Government consents to be sued must be strictly observed and exceptions thereto are not to be implied.'" *Lehman* v. *Nakshian*, 453 U.S. 156, 161 (1981), quoting *Soriano* v. *United States*, 352 U.S. 270, 276 (1957). This principle applies fully to statutes of limitations, even though they may operate to deny a litigant the right to present an otherwise valid claim for recovery from the United States. As this Court has noted, the "very purpose" of a statute of limitations is to "make it impossible to enforce what were otherwise perfectly valid claims" (*United States* v. *Kubrick*, 444 U.S. 111, 125 (1979)). Limitations periods nonetheless "must be strictly adhered to by the judiciary" (*Kavanagh* v. *Noble*, 332 U.S. 535, 539 (1947)). In sum, any limitations period that Congress has imposed as a precondition to suit against the United States must be strictly observed, and failure to comply with that condition bars the court from entertaining a lawsuit.

In this case, a taxpayer is seeking to recover from the government an alleged overpayment of gift tax. The suit was brought under 28 U.S.C. 1346(a)(1) (see C.A. App. 4), which confers jurisdiction on the district courts over a "civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected." That waiver of sovereign immunity, however, is expressly limited by the detailed provisions of Section 7422 of the Code. In particular, Sec-

tion 7422(a) conditions the right to bring such a refund suit upon the taxpayer's first having "duly filed with the Secretary" a claim for refund "according to the provisions of law in that regard." In the case of a tax for which a return is required (which includes the gift tax), Section 6511(a) of the Code requires that this claim for refund be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later. A refund claim filed outside the time limits imposed by Section 6511(a) has not been "duly filed" within the meaning of Section 7422(a), and therefore cannot satisfy the predicate for commencing a suit for refund. See, *e.g.*, *United States* v. *Kales*, 314 U.S. 186, 193 (1941); *Crismon* v. *United States*, 550 F.2d 1205, 1206 (9th Cir. 1977), cert. denied, 434 U.S. 807 (1977); *Clement* v. *United States*, 405 F.2d 703, 705 (1st Cir. 1969).

In this case, Clarence and Ethel Schrier filed their gift tax return, and respondent paid the tax reported on the return, in December 1976. The Schriers paid interest and penalties on the gift tax, for which they were reimbursed by respondent, in March 1977. The period prescribed by Section 6511(a) for filing a claim for refund of the gift tax expired, accordingly, in December 1979, three years after the gift tax return was filed. Repondent, however, did not file her refund claim until November 1984, nearly five years after the limitations period had expired. Thus, under the statutory framework erected by Congress to govern refund suits against the United States, respondent's refund action is unquestionably barred by the statute of limitations. Under fundamental principles of jurisdiction and sovereign immunity, the district court was therefore obliged to dismiss the suit. See, *e.g.*, *United States* v. *Mottaz*, 476 U.S. at 843-844;

United States v. *Garbutt Oil Co.*, 302 U.S. 528, 533-535 (1938); *Nichols* v *United States*, 74 U.S. (7 Wall.) 122, 129-131 (1868); *Yuen* v. *United States*, 825 F.2d 244, 245 (9th Cir. 1987).[5]

B. The Doctrine Of Equitable Recoupment Does Not Confer Jurisdiction Upon A Court To Entertain A Time-Barred Suit

The court of appeals and respondent do not take issue with the foregoing discussion. They agree that this suit does not satisfy the limitations period established by Congress for refund suits, and, as the court of appeals observed (Pet. App. 5a), that "[t]here is no statutory basis for permitting the recovery of a tax overpayment after the statute of limitations has expired." The court of appeals held, however, that a nonstatutory basis exists for the district court to assert jurisdiction over this suit—~~especially~~ specially, the judicial doctrine of equitable recoupment.

This holding reflects a fundamental misconception of that doctrine. Equitable recoupment does not operate to permit suits barred by the statute of limitations, or otherwise to change the conditions upon which Congress has waived sovereign immunity. Rather, it merely permits a litigant to raise, in the nature of a defense or offset in a dispute over which the court does have jurisdiction, a claim that could not be the subject of an independent lawsuit by virtue

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[5] Congress, of course, is free to establish specific exceptions to the general limitations governing refund suits that are embodied in Sections 7422 and 6511(a). Indeed, Congress has taken such action in the mitigation provisions (I.R.C. §§ 1311-1314), which permit taxpayers, in certain specified circumstances involving inconsistent tax treatment, to bring actions that would otherwise be barred by the statute of limitations. See pages 25-27, *infra*. It is undisputed, however, that the mitigation provisions do not apply here. See Br. in Opp. 10, 12.

of the statute of limitations. The doctrine of equitable recoupment therefore does not apply to this case and cannot provide the basis for district court jurisdiction over respondent's lawsuit.

1. The applicability of the doctrine of equitable recoupment to tax cases has its source in this Court's decision in *Bull* v. *United States*, 295 U.S. 247 (1935). *Bull* involved a dispute over the taxation of an estate. The decedent had been a member of a partnership at the time of his death. The partnership agreement gave a deceased partner's estate the right to participate in the earnings or losses of the partnership for a year following the partner's death on the same basis upon which the partner would have participated had he remained alive. In preparing the estate tax return, the executor valued the decedent's interest in the partnership for purposes of computing the gross estate on the basis of the decedent's share of the partnership earnings for that year up to the date of death, *i.e.*, without regard to the estate's share of the partnership earnings for one year after the date of death. On audit of the estate tax return, however, the Commissioner determined that the estate's share of post-death partnership earnings was also a component of the value of the partnership interest includible in the gross estate. This increase in the value of the gross estate yielded additional estate tax liability, which was paid by the estate. Subsequently, the Commissioner determined that the post-death partnership earnings were also includible in the estate's gross income for income tax purposes. The executor challenged this determination by petitioning the Board of Tax Appeals, but the Board sustained the income tax deficiency. 295 U.S. at 251-253.

The executor paid the additional income tax and filed a timely claim for refund, which was denied.

Thereafter, he sued in the Court of Claims for a refund of that income tax payment.[6] The court denied the refund claim, concluding that the post-death partnership earnings correctly had been treated as income of the estate. The Court of Claims also rejected the estate's alternative contention that, if the post-death earnings were correctly categorized as income, the government should have credited against the income tax attributable to this income the amount of the estate tax that resulted from including the same earnings in the gross estate. The court reasoned that it could not consider this alternative claim because the time for filing a claim for refund of the estate tax had expired. See 295 U.S. at 253-254; 6 F. Supp. 151 (Ct. Cl. 1934). This Court reversed. The Court held that, even though the time for filing an independent claim for refund of the estate tax had expired, the doctrine of equitable recoupment permitted the executor to credit an overpayment of estate tax against the correctly assessed income tax liability

[6] The executor followed the correct procedure under then-existing law for contesting the income tax deficiency, although this resort to two different forums would not be permitted today. Sections 284(d) and 1001-1003 of the Revenue Act of 1926, ch. 27, 44 Stat. 67, 109-110, made decisions of the Board of Tax Appeals final, subject to appellate review by the courts of appeals and this Court, as are the decisions of the Tax Court today. See I.R.C. §§ 6512, 7482. Prior to 1926, however, the Board, as established by Section 900 of the Revenue Act of 1924, ch. 234, 43 Stat. 336, had authority to determine deficiencies asserted by the Commissioner, but its decisions were not conclusive. At the instance of the unsuccessful party, the controversy could be heard de novo in a district court or the Court of Claims, where the Board's findings were only "prima facie evidence of the facts therein stated" (Section 900(g), 43 Stat. 337). See S. Rep. No. 398, 68th Cong., 1st Sess. 42-43 (1924).

that was directly at issue in the timely income tax refund suit.[7]

Although the Court permitted the estate in *Bull* to reduce its income tax liability by crediting against it an estate tax payment that could no longer be the subject of a refund suit, the Court made clear that the doctrine of equitable recoupment does not override the constraint on a court's jurisdiction imposed by a statute of limitations. Thus, the Court's decision is fully consistent with principles of sovereign immunity in that it does not permit a court to exercise jurisdiction over an action that does not satisfy the prerequisites to suit established by Congress. Rather, equitable recoupment permits a time-barred claim to be raised only as the basis for an offset or credit against a tax that is the subject of a timely-filed action over which the court properly has jurisdiction.

The Court explicitly stated that any inconsistent treatment suffered by the estate in *Bull* did not provide a basis for avoiding the limitations hurdle erected by Congress (295 U.S. at 259): "[t]he fact that the petitioner relied on the Commissioner's assessment for estate tax, and believed the inconsistent

[7] The Court first rejected the government's argument that it was not inconsistent to impose both an estate tax and an income tax on the post-death profits. 295 U.S. at 255-257. The government had argued that the value of these profits had been transferred at death and also received as income by the estate, and hence the profits were properly subjected to both estate and income taxation, just as this Court had acknowledged that the pre-death profits were subject to both income and estate taxation (see *id.* at 255). See Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax. Law. 625, 635 n.77 (1985).

claim of deficiency of income tax was of no force, cannot avail to toll the statute of limitations * * *." The Court noted therefore that, even though "[r]etention of the [estate tax overpayment] was against morality and conscience" (*id.* at 260), once the taxpayer had failed to seek a refund of estate tax within the applicable limitations period, "[i]f nothing further had occurred Congressional action would have been the sole avenue of redress" (*id.* at 261). The estate's ability to recoup the overpayment of estate tax arose only because that claim could be raised as an offset or credit in a timely-filed proceeding to determine the estate's income tax liability arising out of the same transaction.[8] The Court summarized the operation of the doctrine of equitable recoupment as follows (*id.* at 262 (emphasis added)):

> If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never

[8] The Court noted that, because of the summary nature of administrative procedures for the collection of tax, the position of a taxpayer who is the plaintiff in a tax refund suit is analytically equivalent to that of a taxpayer who is the defendant in an action brought by the government for the collection of taxes. 295 U.S. at 259-260, 262-263. Hence, the Court held that equitable recoupment may be invoked by the taxpayer in a refund suit, even though he is nominally the plaintiff in such an action and "recoupment is in the nature of a defense" (*id.* at 262).

barred by the statute of limitations *so long as the main action itself is timely.*

In sum, although the facts in *Bull* are similar to those of the instant case in many respects, they differ in one respect that the Court identified as critical. The suit in *Bull* was instituted to recover a tax payment for which a timely refund claim had been filed, and the court therefore properly had jurisdiction over the action; here, respondent's suit was brought to recover a tax payment for which a timely claim for refund had *not* been filed, and the district court therefore lacked any basis for jurisdiction over the action.

In subsequent cases addressing the scope of equitable recoupment, this Court has adhered to the clearly stated principle that the doctrine can be invoked only in the general nature of an offset or defense—to reduce a tax liability that is the subject of a timely action—but not to support a court's jurisdiction to entertain an independent time-barred suit to recover funds from the government. In *Stone* v. *White*, 301 U.S. 532 (1937), the Court held that the government also could invoke the doctrine of equitable recoupment in this manner. In *Stone*, a trust had paid its income to its sole beneficiary, but the trust paid the tax due on the income. After the statute of limitations governing the beneficiary's tax liability had expired, the trustees filed a timely suit to recover the tax paid by the trust on the theory that it was the beneficiary, not the trust, that was actually liable for the tax. The government asserted as a defense to the trust's refund suit that, since any recovery would inure to the benefit of the beneficiary, the tax the beneficiary should have paid should be applied to reduce the tax refund claimed by the trust, which would preclude any recovery.

Finding an identity of interest between the trust and its sole beneficiary (see *id.* at 535-537), this Court held that the government could invoke equitable recoupment in the trust's timely refund suit to assert, in the nature of an offset, its claim against the beneficiary, even though the statute of limitations would have prevented it from asserting a deficiency directly against the beneficiary. The Court explained (*id.* at 538-539): "The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment why [the trustees] ought not to recover." The Court further observed that the government was not "reviving a stale claim," but was merely raising a "defense, which inheres in the cause of action, [that] is comparable to an equitable recoupment or diminution of [the trustees'] right to recover." *Id.* at 539. Quoting *Bull* (295 U.S. at 262), the Court reiterated that "'[s]uch a defense is never barred by the statute of limitations so long as the main action itself is timely'" (301 U.S. at 539).

Subsequently, in *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296 (1946), the Court rejected an attempt to invoke the doctrine of equitable recoupment, because the allegedly inconsistent tax treatments in that case did not arise out of the same transaction.[9] Stating that equitable recoupment "has

[9] The facts underlying the taxpayer's claim in *Rothensies* were as follows: The taxpayer paid excise taxes on the sale of storage batteries from April 1919 to April 1926 in the belief that the sales were subject to the tax. In July 1926, the taxpayer sought a refund of the excise taxes it had paid between 1922 and 1926, the statute of limitations on obtaining a re-

never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects * * *" (*id.* at 299), the Court expressly "declin[ed] to expand the doctrine [of equitable recoupment] beyond the facts" of *Bull* and *Stone* v. *White*, *supra* (329 U.S. at 301). In so holding, the Court stressed the importance of statutes of limitations and their role as "almost indispensable element[s] of fairness as well as of practical administration of an income tax policy" (*ibid.*), even though in some cases their application might yield what appears to be an inequitable result. See *id.* at 301-303. The Court expressed its concern that an expansion of the doctrine of equitable recoupment beyond the facts of *Bull* and *Stone* "would seriously undermine the statute of limitations in tax matters" (329 U.S. at 302). The Court concluded (*id.* at 303): "If there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them."

Thus, this Court's decisions permit the doctrine of equitable recoupment to be invoked only to raise a time-barred tax claim as an offset or credit against a related tax claim that is currently being litigated in a timely action. Since the court already has juris-

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fund of the earlier-paid taxes having expired. In 1935, the taxpayer received the tax refund that it sought. Since the refunded taxes had been deducted by the taxpayer during the years it paid them, the Commissioner treated the refund as income in 1935. The taxpayer paid the resulting income tax deficiency and thereafter filed a timely suit for refund, contending that, if the refund was to be recognized as income, it should be permitted "to recoup the amount of the barred excise taxes which it had paid between 1919 and 1922." 329 U.S. at 298.

diction over the action on the main claim—*i.e.*, the claim against which the time-barred claim is to be asserted as an offset or credit—invocation of equitable recoupment does not seek to confer jurisdiction upon the court. Hence, it does not violate established principles of sovereign immunity and jurisdiction. The doctrine does not, however, provide a basis for ignoring the statute of limitations and bringing an independent action on a time-barred claim, as respondent did in this case.[10]

2. a. The courts of appeals generally have recognized that the doctrine of equitable recoupment delineated in *Bull* is limited to use in the nature of an offset in a timely-filed action. Taxpayers have not often sought to invoke the doctrine to support jurisdiction over a suit for the affirmative recovery of a

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[10] The commentators have recognized that the need to raise the untimely claim in the nature of an offset in a timely-filed action is a fundamental constraint on the doctrine of equitable recoupment that is reflected in this Court's decisions. See Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 625 (1986) ("Under the doctrine of equitable recoupment, the barred claim is only usable to reduce or wipe out the open claim, but no more. That is to say, it merely operates as a 'diminution of . . . [the] right to recover' [quoting *Stone* v. *White*, 301 U.S. at 539] on the open claim. Otherwise, it would, in effect, permit the party asserting the barred claim full collection or recovery thereon, thereby completely undercutting the statutes of limitation." (footnote omitted)); Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted by* Chertkof *v.* United States, 38 Tax Law. 625, 633 (1985) ("Recoupment, rather than extending the statute of limitations to correct a perceived injustice, permits a wronged party to recoup the loss against a sum still open to litigation.").

time-barred refund claim, and the courts heretofore have rejected such efforts when they have been made. For example, in *Evans Trust* v. *United States*, 462 F.2d 521 (Ct. Cl. 1972), following a settlement of certain estate tax litigation, the taxpayer filed an independent, time-barred suit seeking an income tax refund on a theory related to the outcome of the estate tax litigation. The Court of Claims emphatically rejected the taxpayer's contention that the court had jurisdiction under the doctrine of equitable recoupment. The court pointed out that the taxpayer's claim was quite different from that presented in *Bull* because it was not "founded on a timely claim for refund" (462 F.2d at 526). The court further explained that the taxpayer's contention could not be accepted because it was "attempting to use recoupment not in its traditional form as a defense to an asserted deficiency, but as an independent ground for reopening years now closed by the statute of limitations" (*ibid.*).

The Court of Claims reaffirmed this fundamental limitation on equitable recoupment in two subsequent cases. In *Brigham* v. *United States*, 470 F.2d 571 (Ct. Cl. 1972), cert. denied, 414 U.S. 831 (1973), the taxpayers brought suit for a refund of tax paid for closed years, arguing that the tax treatment for those years was inconsistent with the government's treatment of similar transactions in later years. The court rejected the argument that the suit could be maintained under the theory of equitable recoupment, stating that the taxpayers "misapprehend the historical function of the recoupment remedy in the tax law" (470 F.2d at 577). The court explained (*ibid.*): "[w]hen its benefits are sought by the taxpayer, the function of the doctrine is to allow the

taxpayer to *reduce* the amount of a deficiency recoverable by the Government by the amount of an otherwise barred overpayment of the taxpayer." Comparing the taxpayers' position to that of the taxpayer in *Bull*, the court emphasized a critical distinction (*ibid.*): "[t]he taxpayers are not seeking to reduce the deficiencies in later years. * * * Rather, the plaintiffs are attempting an extension of the doctrine of equitable recoupment to the case of a refund of taxes for an otherwise barred year." In *Ellard* v. *United States*, 228 Ct. Cl. 815 (1981), the court again reaffirmed these principles where the taxpayer sought to invoke equitable recoupment to provide a basis for jurisdiction over an untimely refund suit that claimed that the taxpayer, in effect, had paid a particular excise tax twice. The court explained (*id.* at 817):

> The plaintiff is not attempting to offset a barred claim against a claim of the Government. Instead, it is using equitable recoupment to revive its own untimely affirmative claim. In *Bull*, *supra*, the Court stated that the "defense" of equitable recoupment "is never barred by the statute of limitations as long as the main action itself is timely." 295 U.S. at 262. Here, the main, indeed, the only action—the plaintiff's refund suit—is untimely.

In *O'Brien* v. *United States*, 766 F.2d 1038, 1048-1051 (1985), the Seventh Circuit similarly emphasized that equitable recoupment cannot provide an independent jurisdictional basis for a time-barred suit. In that case, the IRS had placed a higher value on shares of stock for estate tax purposes than that reported on the return; applying that value to the taxpayer's computation of gain realized from the disposition of those shares would have entitled him to an

income tax refund, but the time for filing such a refund claim had expired.[11] Like respondent here, the taxpayer in *O'Brien* filed an untimely refund claim and brought suit to recover the income tax overpayment. The Seventh Circuit held that the mitigation provisions did not apply and that the doctrine of equitable recoupment did not permit the suit.

The court explained that "it is clear that the doctrine [of equitable recoupment] does not lift the limitations bar to taxpayer's refund suit" (766 F.2d at 1048) because, in contrast to *Bull*, the taxpayer was seeking to invoke the doctrine to maintain an independent, time-barred action, not as a defense in an action that was timely filed. Because it involves a recoupment of one tax payment against another, the court noted, "[t]he doctrine * * * operates only to reduce a taxpayer's timely claim for a refund or to reduce the government's timely claim of deficiency; it does not allow the collection of the barred tax itself" (*id.* at 1049). Hence, the court stated, "the doctrine requires some validly asserted deficiency or refund

[11] The taxpayer had received shares of stock from his father that were later included in the father's gross estate as gifts in contemplation of death (see I.R.C. § 2035). The estate valued the stock at $215 per share for this purpose, and the taxpayer used that same value as his basis in the stock for purposes of computing gain on the subsequent liquidation of the corporation. The IRS asserted an estate tax deficiency, claiming a higher value for the shares. The ensuing Tax Court litigation brought by the estate resulted in the stock's being valued at $280 per share. If the same value were applied to the shares for purposes of computing the gain realized on the liquidation, the taxpayer would have been entitled to a refund of part of the income tax he had paid on the gain. But the taxpayer failed to file a timely income tax refund claim to protect his position pending the outcome of the estate tax dispute.

against which the asserting party desires to recoup a time-barred refund or deficiency * * * and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (*ibid.*) The court then summarized its holding as follows (*ibid.*):

> Attempts by taxpayers to utilize the doctrine to revive an untimely affirmative refund claim, as opposed to offset a timely government claim of deficiency with a barred claim of the taxpayer, have been uniformly rejected. * * * Plaintiff has invoked the doctrine in this precise manner and therefore the district court's holding that equitable recoupment permits the taxpayer's time-barred refund claim must be reversed. O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax and does not seek to offset the amount of a properly asserted and timely deficiency.

Prior to the court of appeals' decision here, the only deviation from this consistent line of precedent was *Kolom* v. *United States*, 791 F.2d 762 (9th Cir. 1986). There, the court permitted the taxpayer to maintain an independent tax refund suit that was concededly untimely,[12] on the theory that equitable recoupment conferred jurisdiction on the court to pre-

[12] *Kolom* involved a dispute over the year for which the taxpayer was liable for the minimum tax. The taxpayer had reported and paid the tax for 1973, but the IRS maintained that it should have been reported for 1972. The taxpayer filed a petition in the Tax Court, which upheld the IRS's determination of a deficiency in minimum tax for 1972. In the meantime, the taxpayer had allowed the time for filing a refund claim for 1973 to expire. Like respondent here, he then filed an untimely administrative claim for a refund of the 1973 tax and thereafter brought suit for a refund in district court.

vent the government from being unjustly enriched. The taxpayer had rested his jurisdictional argument entirely on the mitigation provisions, which the court found to be inapplicable, but the court proceeded to rule on its own motion (see *id.* at 766 n.10) that the taxpayer's refund suit could be maintained under the doctrine of equitable recoupment. The court concluded that the doctrine may be invoked to nullify the statute of limitations whenever the government has been "unjustly enriched" by inconsistent treatment of a single transaction (*id.* at 766-767). The court's failure in *Kolom* to recognize the need for a timely-filed action to provide a basis for jurisdiction appears to rest on a basic misreading of a passage in *Bull*; the court of appeals mistakenly read this Court's explanation of why equitable recoupment can be raised in a timely refund suit commenced by the taxpayer as well as in a timely collection suit commenced by the government (see 295 U.S. at 262-263) as authorizing the invocation of the doctrine in an independent, *untimely* refund suit. See 791 F.2d at 768. The court in *Kolom* did not otherwise explain how its holding can be reconciled with principles of sovereign immunity and statutory limits on jurisdiction, and its decision has been harshly criticized as "simply incorrect." Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 626 n.193 (1986).[13] Thus, *Kolom* provides no reasoned support for the decision below.

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[13] Professor Andrews explained the error in *Kolom* as follows (28 Ariz. L. Rev. at 626 n.193):

> The Ninth Circuit is simply incorrect in this regard because if equitable recoupment is a permissible basis for a refund suit for the barred year rather than the open year, then it completely undercuts the statute of limitation. That this is true is evident from the fact that, in such case, it no longer operates merely to diminish the opposing party's right to recover, but, instead, is serving as an independent ground for obtaining a refund that is directly barred by a statute of limitation.

3. The steps that Congress has taken to address the problem of inconsistent tax treatment of a single transaction further demonstrate that equitable recoupment cannot operate to override the statutory bar to a refund suit that is not based upon a timely filed refund claim. In the wake of *Bull*, Congress acted in 1938 to ameliorate the harsh consequences of the application of the statute of limitations in such cases by adopting the "mitigation provisions" now codified in Sections 1311-1314 of the Code. See Section 820 of the Revenue Act of 1938, ch. 289, 52 Stat. 581. Congress described these provisions as designed "to supplement the equitable principles applied by the courts" (S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938)). The mitigation provisions generally provide that, in certain circumstances involving inconsistent tax treatment, a tax year closed by the statute of limitations may be reopened for the correction of an error, thus permitting a taxpayer to claim and sue for a refund (or the government to assess and collect a deficiency) that would otherwise be time-barred. See generally Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax. Law. 625, 633-640 (1985); Maguire, Surrey, and Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 509 & 719 (1939).

The mitigation provisions were adopted after extensive consideration by Congress (see Maguire, Surrey,

and Traynor, *supra*, 48 Yale L.J. at 510), and they are exceedingly complex. One thing that is clear about the provisions, however, is that they do not provide a blanket exemption from the otherwise applicable statute of limitations in all cases in which a double tax liability has been imposed with respect to a single transaction (see especially § 1312). Indeed, it is undisputed (see Br. in Opp. 10, 12) that they have no application to respondent's situation.[14] This detailed statutory scheme is essentially rendered nugatory by the court of appeals' interpretation of equitable recoupment. If equitable recoupment permits a taxpayer to bring an independent, time-barred action to recover taxes assertedly overpaid because of inconsistent treatment by the Commissioner, there was little reason for Congress to have enacted the mitigation provisions; the otherwise time-barred suits authorized by the mitigation statute could be brought anyway under an equitable recoupment theory. Moreover, the mitigation provisions not only would be superfluous, they would be completely overridden by the expansive theory of equitable recoupment adopted by the court of appeals. The restrictions imposed by Congress upon the mitigation remedy would be nullified, and persons Congress refrained from excepting from the normal statute of limitations rules would nevertheless

[14] The mitigation provisions deal exclusively with *income* taxes; they grant relief where there has been a double inclusion or exclusion of an item of income (or a double allowance or disallowance of a deduction or credit) affecting the computation of income tax. See Treas. Reg. § 1.1311(a)-2(b); Willis, *supra*, 38 Tax Law. at 648-652; but see *Chertkof* v. *United States*, 676 F.2d 984 (4th Cir. 1982). Because respondent in this case seeks to recover a payment of *gift* tax, the mitigation provisions clearly are inapplicable.

be able to maintain time-barred refund suits.[15] Thus, the very existence of the mitigation provisions demonstrates that the court below misapplied the doctrine of equitable recoupment.

4. a. The court of appeals below provided no justification for deviating from the established principle that equitable recoupment may be invoked only in the nature of a defense or offset in a timely suit brought to enforce a related claim that is not barred by the statute of limitations. Relying on *Kolom*, the court stated that there are only three preconditions to the application of equitable recoupment in a tax case (Pet. App. 9a-10a): "[t]here must be (1) a single transaction or taxable event, (2) that event must be subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely." This rule would completely obliterate the statute of limitations for certain taxpayers by giving them unlimited time to seek a refund, no matter how stale the claim. The court of appeals' statement of the prerequisites to application of the doctrine of equitable recoupment finds no support in the decisions of this Court. Indeed, it is contrary to both common sense and settled law.

First, as we have explained, the court of appeals' rule takes no account of the fact that the district court

[15] Indeed, the Ninth Circuit in *Kolom* v. *United States*, *supra*, essentially acknowledged that the mitigation provisions are rendered nugatory if equitable recoupment is understood to permit a taxpayer to maintain an independent action that is barred by the statute of limitations. The court there stated (791 F.2d at 766 n.10): "The doctrine of equitable recoupment essentially requires the same criteria necessary to prove application of the mitigation provisions, the mitigation provisions requiring proof of even further criteria."

lacks jurisdiction over an action that does not satisfy the statute of limitations established by Congress. Thus, the court's list of conditions contemplates refund suits for which no statute confers jurisdiction on the district court, and authorizes recoveries for which the United States has not waived sovereign immunity. Second, the court's statement that equitable recoupment is conditioned upon timely assertion of a deficiency by the government is plainly in error. That statement is inconsistent with *Stone* v. *White*, *supra*, where no timely deficiency was asserted, but the government nevertheless was permitted to invoke the doctrine of equitable recoupment to raise its untimely claim for a deficiency as a defense to a timely refund suit, in order to prevent the taxpayer from paying no tax on the income in issue. More generally, it is clear that a requirement that the government's deficiency notice be timely cannot constitute a meaningful constraint on a taxpayer's ability to invoke equitable recoupment. If the government does not assert its deficiency in a timely fashion, the taxpayer could directly defeat the deficiency on that basis; therefore, the government would not be able to impose the tax liability at all, and the taxpayer would suffer no double taxation that could conceivably provide the occasion for a recoupment claim. Thus, there is no basis for suggesting that the decisions of this Court, or any general equitable principles, make the availability of equitable recoupment relief depend upon the timely assertion of a deficiency.

Perhaps the most conspicuous error of the decision below is that it characterizes as "recoupment" an action that cannot accurately be so described. Respondent's suit, approved under the court of appeals' theory, is an independent action that seeks the payment of funds from the United States to respondent. There is

no timely "main action" (*Bull*, 295 U.S. at 262) involving a different tax liability that respondent seeks to adjust with an offset or credit based on her time-barred claim; there is simply nothing against which the time-barred claim can be recouped.

In describing *Bull* as holding that, "when a single transaction is taxed twice under inconsistent legal theories and the government has collected the second tax in a timely action, the earlier tax can be offset against the later one in an action for refund" (Pet. App. 14a), the court of appeals fundamentally misconceives *Bull* and the concept of recoupment. The doctrine of equitable recoupment recognized by this Court has as its underlying principle the notion of recouping one tax payment by means of an adjustment to another tax liability, which is being litigated in a timely proceeding. See *United States* v. *Gulf Oil Corp.*, 485 F.2d 331, 333 (3d Cir. 1973). The court below ignored the crucial fact in *Bull* that the taxpayer's action was not for refund of the overpayment of *estate* tax, which was time-barred. Rather, the estate in *Bull* sought a refund of *income* tax (although its income tax liability was held to have been correctly computed) on the ground that it was entitled to "recoup" against that income tax the amount of the estate tax that had previously been paid on the same transaction. It is for that reason that this Court emphasized the timeliness of the income tax refund suit, stating that recoupment of the time-barred payment would be allowable "so long as the main action itself [was] timely." 295 U.S. at 261-262; see also *Stone* v. *White*, 301 U.S. at 539.

Here, in contrast to *Bull*, respondent does not assert a timely claim for refund of income tax paid, which could be adjusted to reflect another tax payment. Rather, she is trying to recover directly the gift tax

that she contends was paid erroneously. Accordingly, to label respondent's claim as one for equitable recoupment is a misnomer; she is not trying to offset or credit her time-barred gift tax claim against a countervailing open claim in litigation, because there is no other claim (much less an "open" one) involved in this litigation. Respondent's 1976 and 1977 income tax deficiencies have already been the subject of a petition in the Tax Court, which resulted in a settlement of the income tax controversy, and Section 6512(a) of the Code bars respondent from relitigating those deficiencies here. Therefore, contrary to the court of appeals' suggestion (Pet. App. 10a-11a), those income tax deficiencies cannot now be regarded as an open claim against which recoupment may be had. In sum, respondent's cause of action here is nothing more than an untimely claim for refund of gift tax allegedly overpaid. The doctrine of equitable recoupment has no application to this case, and the district court correctly dismissed the complaint as barred by the statute of limitations.

b. To the extent the decision below rests on the idea that general principles of equity require that the statute of limitations be overridden here in order to avoid double taxation (see Br. in Opp. 5), it is misguided. If respondent has an otherwise valid claim for a gift tax refund that is being denied because of the statute of limitations, there is a sense in which she is being treated unjustly. But that kind of injustice or inequity plainly provides no basis for overriding the statute of limitations, else the statute would become a nullity. As this Court has stated, "statutes of limitations often make it impossible to enforce what were otherwise perfectly valid claims. * * * [T]hat is their very purpose" (*United States* v. *Kubrick*, 444 U.S. 111, 125 (1979)). Thus, limitations periods can "operate harshly and arbitrarily with respect to individuals" whose claims are adversely affected by their enforcement (*United States* v. *Locke*, 471 U.S. 84, 101 (1985)), but they nonetheless must be "strictly observed" (*Soriano* v. *United States*, 352 U.S. at 276).

This strict adherence to statutes of limitations is appropriate because such statutes, as a whole, enhance the fairness of the judicial system by preventing litigation of stale claims; hence, the Court has characterized "the plea of limitations as a 'meritorious defense, in itself serving a public interest'" (*United States* v. *Kubrick*, 444 U.S. at 117, quoting *Guaranty Trust Co.* v. *United States*, 304 U.S. 126, 136 (1938)). Indeed, the Court has commented on this incongruity in the context of equitable recoupment itself, noting that "[i]t may easily be overlooked, when the unfairness of the Government's retaining incorrectly collected monies of [the taxpayer] is stressed, that the statute of limitations is primarily an instrument of fairness" (*Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. at 302 n.3). Notwithstanding that potential for unfairness in the individual case, the Court emphasized that courts must resist the "tempt[ation] * * * to seek for ways of relief in individual cases" (*id.* at 302) and instead must apply statutes of limitations as they have been established by Congress.

Respondent is in the same position here as any other taxpayer who has overpaid his taxes, but whose refund claim is barred by the statute of limitations. Her assertion that she has been subjected to "double taxation" (Br. in Opp. 3) does not entitle her to special treatment; a "taxpayer is no more deeply out of pocket" for having paid a tax twice, "once erroneously and once correctly," than for having paid one

erroneous tax. Maguire, Surrey, and Traynor, *supra*, 48 Yale L.J. at 516. If the unfairness of being unable to recover an overpayment of tax is sufficient reason to permit an untimely refund suit, statutes of limitations are meaningless. They would bar only unmeritorious claims—which, of course, can be distinguished from those that are meritorious only by litigating the merits in each case.

Moreover, respondent's claim that she has been subjected to double taxation is highly questionable in any event. The total tax collected by the government (including the gift tax in question here) was less than the amount of the asserted income tax deficiency, *i.e.*, the tax due if the payments in question were income. The district court observed (Pet. App. 20a) that the income tax settlement in the Tax Court appeared to be designed to credit respondent for the gift tax she had paid—an issue that the court of appeals held should be considered on remand after further factual development. Even if we assume that the settlement did not include a credit for the gift tax paid, it is apparent that most of the gift tax cannot be regarded as double taxation. The settlement provided for a sharp reduction in the deficiency asserted for 1976, the year in which the gift tax was paid, which means that most of the payment for that year ultimately was not treated as income.[16] Accordingly, most of

[16] The income tax deficiencies were based on a recalculation grounded in the assumption that the payments to respondent were income. See C.A. App. 48-55. This calculation yielded income tax of $91,471 on the $180,000 payment made in 1976 and $70,639 on the $133,813 payment made in 1977 (on which no gift tax had been paid). The Tax Court settlement (for half of the total deficiency) upheld the 1977 deficiency in full, but held that only $10,416 in income tax was owed for 1976. This was less than 12% of the asserted income tax deficiency for that year, and therefore the settlement did not treat the bulk of the 1976 payment as income.

the 1976 payment should have been subject to gift tax; respondent's effort, in the wake of the Tax Court settlement, to obtain a refund of all of the gift tax paid seeks to insulate most of the 1976 payment from taxation entirely. In sum, there is no singular injustice on the facts of this case, and there is certainly no basis for creating a special exception to the statute of limitations.

The doctrine of sovereign immunity can sometimes leave an injured party without a remedy, but this is not such a case. Respondent had available to her avenues to seek to recover the gift tax that she allegedly overpaid. Even after the time to seek a gift tax refund directly had expired, she still had the opportunity to raise a claim of equitable recoupment. If respondent had paid the 1976 and 1977 income tax deficiencies asserted against her and then brought a timely refund suit in district court or the Claims Court, she could, under *Bull*, have invoked the doctrine of equitable recoupment in that action and sought to diminish the amount of the income tax deficiencies by the amount of the gift tax she had paid. See also Rev. Rul. 71-56, 1971-1 C.B. 404 (IRS will consider equitable recoupment claim administratively).[17] Having failed to pursue these available ave-

[17] It is doubtful that respondent could have raised an equitable recoupment claim in the Tax Court, where she chose to contest the income tax deficiency. In *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943), this Court held that the Tax Court's predecessor, the Board of Tax Appeals, lacked jurisdiction to consider the taxpayer's equitable recoupment claims. It is generally believed that this restriction applies to the Tax Court today, which is a legislative court with a narrowly prescribed statutory jurisdiction. See *Rothensies*

nues for relief, she should not now be heard to complain that it is unfair to apply the statute of limitations to her untimely refund suit.

This case is controlled by the statutory scheme established by Congress governing suits against the United States to recover tax overpayments. Congress has placed restrictions on its waiver of sovereign immunity for such suits—specifically, it has prohibited the maintenance of a refund suit in court unless a timely refund claim has been filed. In the mitigation provisions, Congress has relaxed these requirements in certain specified circumstances. Respondent's refund suit is untimely under the general rules applicable to such actions, and the suit is not authorized by the mitigation provisions. The courts are not authorized to alter the conditions under which the United States, as sovereign, has waived its immunity from suit, and hence they lack jurisdiction to entertain this suit. As this Court stated in *Rothensies* (329 U.S. at 303), "[i]f there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them."

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v. *Electric Storage Battery Co.*, 329 U.S. at 303; *Elbert* v. *Johnson*, 164 F.2d 421, 423 (2d Cir. 1947); 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 115.2.7, at 115-24 to 115-25 (1981); Willis, *supra*, 38 Tax Law. at 641-642 & n.130; Andrews, *supra*, 28 Ariz. L. Rev. at 613-615; see also I.R.C. § 6214(b). The Tax Court itself has stated that it is subject to the rule of *Gooch Milling*. See *Estate of Schneider* v. *Commissioner*, 93 T.C. No. 47 (Nov. 6, 1989); *Estate of Van Winkle* v. *Commissioner*, 51 T.C. 994, 999-1000 (1969); *Estate of Garber* v. *Commissioner*, 17 T.C.M. (CCH) 646 (1958), aff'd on another issue, 271 F.2d 97 (3d Cir. 1959).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1989

APPENDIX

Section 6511 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Limitations on credit or refund

(a) Period of limitation on filing claim

Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

• • • •

Section 7422 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Civil actions for refund

(a) No suit prior to filing claim for refund

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

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In The

Supreme Court of the United States

October Term, 1989

UNITED STATES OF AMERICA

Petitioner,

v.

FRANCES L. DALM

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Where the Government has asserted a timely income tax deficiency against Taxpayer and, as a result two taxes have been collected on the same taxable event on mutually exclusive theories, does equitable recoupment permit the Taxpayer to maintain a suit against the Government to reduce the amount received by the Government?

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CORRECTION TO PETITIONER'S STATEMENT OF THE CASE

Prior to the Tax Court's Decision on December 4, 1984, Respondent's claim for refund was filed November 1, 1984. (See C.A. App. 7, 9) As the claim was filed in recoupment against a timely claim of the Government, the claim was timely. The Government's assertion that the claim was untimely and that suit is otherwise barred as untimely by Sections 7422 and 6511 of the Internal Revenue Code are not statements of fact but their conclusions of law.

The Government draws conclusions from use of the words "payment," "paid the reported gift tax," "claim was untimely," and "the suit unquestionably was untimely." A more accurate statement is that "Respondent received from Clarence . . . " monies in the amounts stated and that "Respondent sent a check to the Internal Revenue Service in 1976 which was intended to pay the reported gift tax of $18,675."

The above distinction is material only because of the Government's repetitive conclusions of "untimely" which are utterly inconsistent with its position that the transfers in question were income in which case there was no gift, no gift tax return required and hence no gift tax. It therefore follows under the Government's logic that the gift tax was not paid in 1976 within the strict meaning of Section 6511 of the Internal Revenue Code. Hence, the two (2) year period did not begin to run in 1976 and the suit was timely.

Moreover a forthright statement should include the Government's implicit admission that the essential elements of equitable recoupment mandated by *Bull v.*

United States, 295 U.S. 247 (1935), *Stone v. White*, 301 U.S. 532 (1937) and *Rothensies v. Electric Storage Battery*, 329 U.S. 296 (1946) are present in *Dalm*.

SUMMARY OF ARGUMENT

The only distinction between *Bull* and *Dalm* is a meaningless procedural distinction which, if dispositive, would have rendered the *Bull* decision obsolete upon issuance, contrary to the philosophy behind adjudication by the Supreme Court.

Equitable recoupment requires that a single transaction be subjected to two taxes on inconsistent legal theories. In *Dalm* it was the identical receipt of money. The right to recoupment does not arise until the second tax is collected. The erroneous tax is not "erroneously paid" until the second tax is collected. Therefore it is unnecessary for the Plaintiff to show that her suit was "timely" as the term is used by the Government.

The point that the Government refuses to recognize is that the taxpayer had no action to bring with respect to the "erroneously paid" gift tax and overpaid income tax until the Settlement and Tax Court decision determined that an income tax would be collected. If the IRS had properly credited the gift tax payment against the amount of income tax which was due, then no action would have been necessary. It was only after the Revenue Service determined that the income tax was due without giving credit for the tax already paid on the transaction that the doctrine of equitable recoupment became applicable. Therefore, pursuant to the doctrine of equitable

recoupment, Respondent's action survives as long as the Government's action survives against her. Furthermore, the defense of sovereign immunity was waived by the Government when it proceeded against the Respondent for $160,000 additional income tax.

Respondent's action was not an "independent" action as that term has been defined by the cases. An "independent action" is that which does not seek to recoup a claim against the amount of a properly asserted and timely deficiency. The Taxpayer's action arises because the Government asserted a timely deficiency.

A correct reading of *Bull* indicates that the Government's assertion of a deficiency is the "main action" which must be timely to allow a claim of recoupment. None of the cases cited by the Government present a situation in which recoupment was not allowed when two taxes have been collected on the same identical taxable event and the Government has asserted a timely deficiency. All of the prior cases cited in *Bull* support this interpretation of the Court's reasoning. A recoupment claim survives as long as the claim opposing it without regard to how the party asserting the main claim proceeds.

The legislative history of the mitigation provisions reveal that these provisions deal with income tax alone and were meant to complement and not replace equitable recoupment.

In conclusion, the Court of Appeals holding in *Dalm* is consistent with the philosophical theory underlying statutes of limitations. No stale claims are involved. The Tax Court decision as to whether the sums involved were

income was equally dispositive as to whether they were gifts. The Government decided to litigate the one claim, and the determination as to the one was automatically determinative of the other and those conclusions already reached mandate a refund to the Taxpayer.

I. THE *DALM* CASE IS IDENTICAL IN ALL SUBSTANTIVE RESPECTS TO *BULL V. UNITED STATES*

The foundation of the doctrine of equitable recoupment as applied to Federal tax cases was, as both sides agree, *Bull v. United States*, 295 U.S. 247 (1935). If it is held that Plaintiff Frances Dalm's situation is, in substance, that of the Plaintiff Estate in *Bull*, Plaintiff (Respondent) should prevail.

In both *Bull* and *Dalm*, the Taxpayer voluntarily paid a non-income tax (in *Bull*, Estate Tax and in *Dalm*, Gift Tax). In both cases, the Government then asserted a deficiency in income tax, a deficiency the Taxpayer opposed in the Tax Court (Board of Tax Appeals in *Bull*). Both taxpayers were held to owe income tax, which was then paid. Both then filed suits for refund.

The Government argues that in *Bull* the properly owed tax (the income tax) was still subject to a suit for refund and it was as a credit against the proper income tax that the improper estate tax was recouped. *Bull* was decided in 1935 but involved a tax year prior to 1926 when the decisions of the Board of Tax Appeals were not conclusive whereas, the Revenue Act of 1926 made decisions of the Board of Tax Appeals final. Accordingly, it must be concluded, if such a distinction is controlling,

that this court formulated a fundamentally fair doctrine in 1935 in a situation which, due to the change of statute, would never occur again. Respondent therefore respectfully submits that in order for the Court to hold in favor of the Government, it must also be concluded that the Supreme Court decreed an equitable doctrine in a situation where it was against morality and conscience for a certain result to occur and then placed prerequisites in its Opinion to assure the doctrine would never be used in precisely the same way again. Such a conclusion places the Court on a lower plane and ignores the role of the Supreme Court which is not only to rectify injustices in particular instances but to provide guidance for the jurisprudence of the nation.

Part of the controversy is generated by the meaning of the term "recoupment." Obviously, more is required than that an otherwise valid claim be barred by the Statute of Limitations. More is required than that the Government have a valid claim against the Taxpayer against which the Taxpayer can set off its barred claim against the Government. What is required is that the two claims be so intimately related that the decision as to one results almost automatically in the decision as to the other. As set forth in *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 299-300, (1946) referring to *Bull* and *Stone*:

> "In both cases a single transaction constituted the taxable event claimed upon and the one considered in recoupment. In both, the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories, and what was mistakenly paid was recouped against what was correctly due."

A single transaction and a single taxable event must be involved and must be examined "in all of its aspects" in order to render judgment that does justice in view of the transaction as a whole, *Dalm v. United States*, Pet. App. 9a citing *Electric Storage Battery*, at 299. Once it is determined that a tax is owing on a single transaction which transaction has been subjected to a prior tax on an inconsistent legal theory automatically and only at the instant the proper tax is determined, the previously collected tax may be recouped against the properly owed tax. In effect, the improper tax becomes paid only at that point because only then have facts been determined to support the conclusion it was improperly paid. From that point on (the final determination of the proper tax) the Taxpayer has two years to seek a refund. A correct tax having been determined and paid, there is now a fund to recoup against. The recoupable portion of the properly payable tax has become available and should be instantly refunded. In *Dalm* administrative remedies were exhausted by filing the claim for refund which Respondent mistakenly anticipated would be forthcoming. Therefore, a suit for refund in the District Court is available and was the proper remedy.

II. TAXPAYER'S ACTION WAS TIMELY

Heretofore, the Respondent has not sought to show that her suit was timely in that the cases are clear that it is the action of the Government that must be timely. It is undisputed that the action of the Government in this case, its determination that Respondent owed an income tax, not a gift tax, was timely.

In fact, the Respondent's action has been timely because the gift tax only became refundable upon the payment of income tax on the same sum of money because then and only then was the gift tax overpaid. For the entire period from 1976 to 1984, only one improper tax had been collected on the transaction in question, the gift tax. There was no cause to seek a refund of such tax because the only possible justification for claiming that a gift tax was not owed was that the transaction was not a gift. However, when it was determined that income tax was owed on the transaction, *then and only then* was the gift tax refundable. The Dalms' action therefore was properly filed within two years.

Periods of limitations generally are triggered by the accrual of the cause of action. An action generally accrues at the time the last event rendering the cause of action complete occurs. In most tax cases, the cause of action becomes complete at the time the tax is paid. However, in a case requiring the application of equitable recoupment, the cause of action is rendered complete by a second tax being collected on the same fund of money as respects the same party in the same transaction. Accordingly, the improper tax in *Dalm* was only paid at the time (1984) when the payment of the proper tax rendered the original payments improper. Otherwise, the statute of Limitations will have expired on an inchoate cause of action before the cause of action has arisen. Thus, the claim should be considered timely within the meaning of Section 6511 of the Internal Revenue Code. Judge Learned Hand's observation in *Elbert v. Johnson*, 164 F.2d 421 (2nd Cir. 1947) at 425-426 is apposite despite the Government's inaccurate paraphrasing and erroneous statement, (at page 8 of its

Brief In Reply to Respondent's Brief opposing the Petition for *Certiorari*), that the language in *Bull* contradicted such statement. The Government changed Hand's word, "assert" to "litigate" and failed to inform this Court that the language from *Bull* was taken out of context. Judge Hand cogently stated:

> "That decision (*Bull*), as I understand it, permits a taxpayer without penalty to assert his version of a transaction, until it is finally decided against him. That is to say, if the transaction, is susceptible of two interpretations, and the taxpayer has paid a tax which was required by the interpretation he puts upon it, he does not forfeit his right to a refund of that tax, because the statute of limitation has run against him before the Courts have finally decided that his interpretation was wrong; the statute is tolled."

The claim for refund did not arise *ab initio* upon the payment in 1976 on the ground that the gift tax was improperly paid. The action for refund of the gift tax arose because an income tax has been determined and collected and the income tax was not collected until 1984.

Despite its inconsistency as pointed out in the Correction to Statement, the Government argues that the statutory scheme constitutes an exception to sovereign immunity and, as such, the statutes must be strictly construed. In effect, the Government states the sovereign need not have consented to be sued at all and therefore it does not matter how unfair the statutory scheme is. The sovereign cannot fail to allow due process in the suits it allows against itself because the conditions Congress places on its consent for the sovereign to be sued must be constitutional. See *Deakyne v. Department of Army Corps of*

Engineers, 701 F.2d 271, 174 (3rd Cir. 1983). It could hardly be argued that Congress could limit an action to members of one race or religion. An action that is barred by the Statute of Limitations before it accrues is a violation of due process because there has been no fair opportunity to be heard. See *Logan v. Zimmerman Brush Company*, 455 U.S. 422, 429, 71 L.Ed.2d 265, 102 S. Ct. 1148 (1982) and the cases cited therein. The Government's emphasis on absolute sovereign immunity makes one think we live under a monarchy rather than our beloved republic.

Further, the Government has waived any sovereign immunity by bringing an action against the Dalms for additional income tax.

> "The general rule is that when the sovereign sues, it waives immunity as to claims of the Defendant which assert matters in recoupment arising out of the same transaction or occurrence which is the subject matter of the Government's suit and to the extent of defeating the Government's claim but not to the extent of a judgment against the Government which is affirmative in the sense of involving relief different in kind or nature to that sought by the Government or in the sense of exceeding the amount of the Government's claims . . . " *U.S. v. Johnson*, 853 F.2d 619 (8th Cir. 1988) citing *Frederick v. United States*, 386 F.2d 481, 488 (5th Cir. 1967)

The Government, by asserting a deficiency for additional income tax has opened itself up to claims of recoupment against that deficiency. Respondent has used recoupment "in the nature of a defense" (*Bull* at 262) and her claim cannot be barred as long as the Government's claim is not barred.

III. TAXPAYER'S ACTION WAS NOT INDEPENDENT

After the initial cases of *Bull* and *Stone*, this Court defined the essence of the doctrine of equitable recoupment as preventing the collection of two inconsistent taxes on the same receipt of funds by the same Taxpayer.

The Court of Appeals in *Dalm* was absolutely correct in stating that: "The facts in *Rothensies v. Electric Storage Battery* were quite different from those in *Bull* and the present case." The Special Assistant to the Attorney General who argued the *Electric Storage Battery* case pointed out that recovery in that case would not be supported upon equitable principles of recoupment and more importantly that *Bull* was inapplicable because the barred excise taxes did not arise out of the same transaction as the income taxes. While the Taxpayer's suit for refund in *Electric Storage Battery* was conceded as timely, the claim pleaded as a recoupment was for taxes collected over twenty (20) years before on completely different transactions than the transactions on which the tax had properly been paid. There was no single taxable event that had been subjected to two taxes on inconsistent legal theories. *Bull*, *Stone*, the *Dalm* case, and *Electric Storage Battery* are consistent. All stand for the proposition that the doctrine of equitable recoupment is applicable only where a single taxable event and single transaction has been subjected to two taxes on inconsistent legal theories. However, in *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985), *Electric Storage Battery* and the other cases cited by the Government, the doctrine correctly should not have been applied and was not. It should be emphasized that in *Electric Storage Battery*, no issue was involved regarding

the suit for refund being timely but recoupment was still improper because the taxes did not involve a single transaction.

The Government makes much ado over whether an action is "independent" with the frequent admonition that the doctrine of equitable recoupment does not permit an independent action. Respondent submits, however that "independent" has a rather specialized meaning in this context. An "independent" action is an action that does not follow a timely assertion of a deficiency on the part of the Government.

Dalm is not *an independent suit* as the Seventh Circuit in *O'Brien* defined one because the deficiency for additional income tax asserted by the Government against Frances Dalm was timely. In *O'Brien*, at page 1049, it is stated "O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax and does not seek to offset the amount of a properly asserted and timely deficiency." The Court concluded that *"This Court sees no grounds for extending the doctrine and the Plaintiff offers none"* for the very reason that the Plaintiff was not seeking an offset against a properly asserted and timely deficiency. The *Dalm* suit, likewise, because recoupment is sought by the proper person against a properly owed tax paid by the same Taxpayer, pursuant to the stipulated Order of the Tax Court after the government's timely assertion of a deficiency, is not an independent action as the Seventh Circuit uses the term.

The Court in *Bull* discussed at length the nature of tax litigation, explaining that tax litigation is essentially an action for debt with the order of events reversed because the sovereign is the Creditor. Instead of a suit for debt followed by collection, in the case of a tax suit, the collection comes first.

> "If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the Statute of Limitations had barred an independent suit against the Government therefor." *Bull* at 262

The Court further stated:

> "In a proceeding for the collection of estate tax, the United States through a palpable mistake took more than it was entitled to. Retention of the money was against morality and conscience. But claim for refund or credit was not presented or action instituted for restitution within the period fixed by the Statute of Limitations. *If nothing further had occurred Congressional action would have been the sole avenue of redress." Id.* 260-261

But something further did happen as described by the Court in the very next line, "In July, 1925, the Government brought a new proceeding arising out of the same transaction involved in the earlier proceeding." Thus, the Government asserting a timely deficiency of income tax is what revitalized the claim for Estate Tax. In the present case, as in *Bull*, if the Government had not brought an action for the income tax deficiency and the statute of limitations expired on the gift tax claim, then the gift tax

could not have been questioned. The statute of limitations would have barred the claim, but since the Government sought to collect a different tax on the same transaction, the Dalms have the right under equitable recoupment to reduce the net amount collected by the Government.

The doctrine of equitable recoupment could not be raised and was irrelevant to the issues before the Tax Court in *Dalm* as the Government agrees. Now that the action has moved to the District Court and involves a matter of collection the doctrine of equitable recoupment becomes relevant to defend the Dalms against the collection of the wrong amount of tax.

The Government has cited three separate cases for the proposition that the doctrine of equitable recoupment did not allow the institution of an "independent" suit. All of such cases are distinguishable from the case at bar. In none of these cases did the suit follow the timely assertion by the Government of a deficiency. Moreover, the Government's reliance on such cases is misplaced because the cases did not contain the essential elements of equitable recoupment.

In *Brigham v. United States*, 470 F.2d 571 (Ct. Cl. 1972) *cert. denied*, 414 U.S. 831 (1973) the Taxpayer had sold stock on an installment basis and reported the installments as capital gains for the taxable years 1958-1961. The returns were examined, the installments reclassified as ordinary income, and the Taxpayers paid the determined deficiencies. Subsequently, the Supreme Court decided in a similar case that the original capital gains treatment had been correct. The Taxpayers sought

refunds for the income tax they had "erroneously paid." There was no deficiency against which to recoup such refunds. Neither were two different taxes collected on the same transaction. Only one tax was collected. The Taxpayers could have litigated the question, did not, and then, finding they would have won, regretted it.

No deficiency was collected by the Government on a receipt of money by the Taxpayer on which tax had already been paid on an inconsistent theory. It was acknowledged by both parties that the receipt was income. The Taxpayers had merely been incorrectly deprived of the capital gains exclusion in the barred years. Not only was the Taxpayers' action totally "independent" in every sense of the word but the facts did not contain the essential elements giving rise to equitable recoupment.

Respondent never had the opportunity or necessity to question the correctness of the gift tax payment until the Government asserted the transfer of money was additional income on which income tax was due. The finding that the receipt was income automatically (and for the first time) made the gift tax payment wrong. There was no equivalent event in *Brigham*. The receipt of income had been in years and with regard to transactions that the Government had made no move to revisit.

Evans Trust v. United States, 462 F.2d 521 (Ct. Cl. 1972) involved a Trust that had in years past, paid income tax on the receipt of installment payments from certain notes. The deceased trust beneficiary (the Estate) undervalued property in its estate tax return. The terms of the Tax

Court settlement were that there was no deficiency in estate tax but that the notes should be included in the estate thereby resulting in income in respect of a decedent.

The Trust had not been a party to the Tax Court litigation nor had any deficiency been determined as a result of the Tax Court action. No deficiency had ever been asserted against the Taxpayer trust and certainly no deficiency based on treating a receipt of money on which tax had already been paid as taxable on an inconsistent theory. A "new" tax had become payable, resulting in a theoretical "deduction" that could not be taken because the years were closed. This is entirely different from a second tax being collected on payments on an inconsistent theory against which the first tax should be credited. The relationship was so abstract that it took the interested parties six months after the settlement to realize that the revised tax treatment for the Estate might give rise to a deduction for a related Taxpayer, the Trust. During that time, the Statute expired on one of the tax years involved. The Dalms' claim required no extended analysis. If the money was income, it was not a gift which conclusion was axiomatic and elementary as evidenced by the immediate claim for refund prior to the Tax Court's decision becoming final.

Ellard v. United States, 228 Ct. Cl. 815 (1981) is even more different. Indeed, the Government had assessed no deficiency against the Taxpayer for him to recoup the taxes against. It concerned excise taxes paid on fuel sold

for highway use. An individual sold the fuel to a partnership and paid excise taxes on the sale. The partnership sold it to the public and did not pay excise taxes. The Government asserted a deficiency against the partnership, *which the partnership was still contesting* at the time of the suit for refund by the individual. Two separate transactions were involved, and accordingly, the test of *Rothensies v. Electric Storage Battery* was not met.

An action is not "independent" if the "main action" is timely. See *Bull* at 262. The Government has wrongly implied that the "main action" which must be timely is the Taxpayer's action. In *O'Brien*, it is clear that the "main action" that had to be timely was the government's assertion of a deficiency and not the Taxpayer's claim for refund. The *O'Brien* court recognized the distinction in stating at page 1049 that the doctrine will "permit a taxpayer to recoup an erroneously paid tax, the refund of which is time barred, against a timely and correctly asserted deficiency by the government." In fact, later on in its opinion, the Court set forth an instance in which equitable recoupment *perhaps could* have applied as follows:

> "The estate potentially could have recouped Michael O'Brien's income tax overpayment against the excess estate tax owed by the estate *resulting from the Tax Court's stipulated order.* Assertion of the doctrine would be proper because the 'main action,' the government's deficiency suit, would be timely." (emphasis added) *O'Brien* at 1050.

Interestingly enough, the Court's precise language is applicable to the present case as follows:

> "Dalm could recoup her gift tax overpayment against the excess income tax resulting from the Tax Court's stipulated Order, assertion of the doctrine . . . "

However, even were the above not compelling enough, what the Court in *Bull* meant by the "main action" can be determined by referring to the eight cases cited by the Court for its proposition. In every one of the cases cited by the Court, the "main action" is that brought by the opponent of the party with the recoupment claim.[1]

The theory upon which the Court based it decision is well exemplified by this statement in *Williams* at 13:

> "The defense of reduction or recoupment which arises out of the same transaction as the Note or claim survives as long as the cause of action upon the note or claim exists, although an affirmative action upon the subject of it may be barred by the Statute of Limitations."

In the present case, Dalms' claim for Refund was filed November 1, 1984 *before* the decision was entered in the Tax Court Case (December 4, 1984) and well before that decision was final. The main claim surviving, so did

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[1] *Blackshear v. Dekle*, 120 Ga. 766; 48 S.E. 311 (1904); *Aultman & Co. v. Torrey*, 55 Minn. 492; 57 N.W. 211 (1893); *Kaup v. Schinstock*, 88 Neb. 95; 129 N.W. 184 (1910) and *Campbell v. Hughes*, 73 Hun. (N.Y.) 14, 25 N.Y.S. 1021 (1893); *Williams v. Neely*, 134 Fed. 1 (8th Cir. 1904); *Conner v. Smith*, 88 Ala. 300, 7 So. 150 (1889); *Stewart v. Simon*, 111 Ark. 358, 163 S.W. 1135 (1914); *Beecher v. Baldwin*, 55 Conn. 419 (1887).

the recoupment claim. The Tax Court had no jurisdiction over a gift tax claim (there was no deficiency in gift tax to invoke such jurisdiction) but the District Court did. Taxpayer properly proceeded.

This Court in *Bull* as shown by the cases it cited, approved a theory of recoupment in which choice of forum or manner of proceeding does not affect the right to recoupment. In *Conner v. Smith*, a Mortgagor had recoupment against a Mortgagee who took personal property not mortgaged along with real property. The Court stated:

> "Shall this right be defeated, and the benefit of the exception to the Statute of Limitations be denied to the Complainants, because, instead of proceeding by bill, the election was made to foreclose by a sale under the power? . . . (C)an the circumstance of a mere difference in the modes by which the mortgagor is put to his defense, defeat and operate to deny the defense? We think not. It is very true, that the case does not come precisely within the letter of the law; but, it is also true, that such a defense in equity can never come precisely within the letter of a statute applicable by its terms to actions at law . . . So long as the contract, upon a breach of which the claim is predicated, subsists and may be enforced, the claim itself may be pleaded in reduction." 7 So. at 153

IV. THE MITIGATION PROVISIONS ARE COMPLEMENTARY AND DEAL WITH COMPLETELY DIFFERENT SITUATIONS.

The Government continues to claim that the mitigation provisions of the Internal Revenue Code (Sections

1311-1314) are the exclusive remedy when inconsistent positions of the Internal Revenue Service subject a Taxpayer to double taxation. This is despite the fact the mitigation provisions deal solely with income tax and would not have helped the Taxpayer in *Bull*.

The intent of Congress with regard to the mitigation provisions is set forth in S. Rep. No. 1567, 75th Cong. 3d Sess. 49 (1938)

> "The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

Accordingly, it is clear no replacement of equitable recoupment by mitigation was intended, nor were the mitigation provisions intended to be exclusive. Indeed, Congress sanctioned the Court's application of recoupment.

That the Government seeks to use the statute of limitations in the precise manner disapproved of by Congress can be seen by considering the implications of their inconsistent positions to the Estate of Harold Schrier. The income or gift was received by Frances Dalm when she was serving as Administratrix of that estate. If it was not a gift, presumably the Estate would have been entitled to a deduction. If the deduction was granted, the Government would be treating the transfer as income in all instances except the Dalms' claim for refund of gift tax. If no deduction was granted, as we believe was the case, the Government is in the position of maintaining in each instance (with regard to estate tax, gift tax and income tax) that position (gift or executor's fee) that maximizes its tax receipts without regard to consistency or principle. The government should not be permitted to exploit, by the benefit of the statutory bar, opportunities only open to it if it assumes a position diametrically opposed to that taken prior to the running of the statute. This Court should take the profit out of the government's inconsistency by reaffirming its doctrine of equitable recoupment in the instant case. The Government seeks to make a profit taking inconsistent positions. The Government should be seeking respect and fairness in the equal administration of the tax laws, not the quick profits of a wall street trader.

V. THE HOLDING IN *DALM* IS NOT INCONSISTENT WITH THE THEORY OF STATUTES OF LIMITATION

The rationale of statutes of limitation as they relate to equitable recoupment is set forth in Andrews, *Modern-*

Day Equitable Recoupment and the "Two Tax Effect," Avoidance of the Statutes of Limitation in Federal Tax Controversies, 28 Ariz. L. Rev. 595, 645-646 (1986).

> "Given the foregoing reasons for the existence of tax limitation statutes, particularly that of preventing the litigation of stale claims, their relationship to the single transaction element of equitable recoupment and to the automatic facet of *Bull*, quickly becomes apparent. The Supreme Court seemingly imposed the single transaction element of the doctrine because it helps avoid the very staleness problem against which limitations are principally directed. Where a single item, transaction or taxable event is under scrutiny in connection with the open claims of one party, the facts of such transaction relating to the barred claim of the other party are, almost be definition, the same or related and substantially known. Consequently, the single transaction concept helps ensure a minimal staleness problem. Obviously in such a situation the negation of a statute of limitation by the application of equitable recoupment is more palatable.
>
> The same may be said of the automatic facet of *Bull* . . . The determination of the open claim leaves little or no factual issue with respect to the barred claim, and hence, no real problem of staleness exists. Unlike the justifiable fear voiced by the Court in *Electric Storage Battery*, here no search with respect to the barred claim is either invited or necessary as it is already automatically known."

The "automatic feature" of *Bull* is described at 644.

> "Another obvious, but unemphasized, feature of *Bull*, however, was the automatic nature of its conclusion with respect to the barred estate tax refund claim of the taxpayer once the Court made its determination as to the open income

> tax claim of the government (being litigated in the setting of the taxpayer's income tax refund suit). That is, once the court determined that the post-death partnership profits were properly subject to the income tax, it was pretty much automatic, in the circumstances of that case, that such profits had been improperly subjected to the estate tax."

With respect to the Government's claim that the decision below would undermine the goals of finality and repose, the following language at page 646 is particularly appropriate:

> "the concept of final repose also does not seem to be of overwhelming importance where the claim of one party may only be inchoate or not even exist until the determination concerning the open claim has occurred, at which time the former may already be barred."

In *Dalm* as in *Bull*, nothing is left to be determined on stale evidence. If it was a gift, it was not income. If it was income, it was not a gift. The Tax Court's decision gave rise to a circumstance (gift tax collected on income) that automatically required a recoupment or set-of.

The Government cites *Andrews* without regard to his more philosophical considerations simply for his footnote claim that *Kolom v. United States*, 791 F.2d 762 (9th Cir. 1986) is "incorrect." If *Kolom* is "incorrect" it does not follow that *Dalm* is incorrect. *Kolom* involved only income tax and the mitigation provisions applicable to income tax only may have been his exclusive remedy, unlike *Dalm* where a non-income tax is involved. *Kolom* also differs from *Dalm* in that it is not clear whether his claim was filed while the main action was pending, a factual issue not present in *Dalm*.

Nevertheless, it is clear that Andrews did not analyze *Kolom* rigorously in line with his own scholarly analysis of the rationale behind statutes of limitation. The statute of limitations is not undercut if the only time-barred claims affected are those "automatically" valid by a judicial determination of the nature of the transfer involved, a description which fits *Kolom*. If *Kolom* received the income in 1972, it is plain he did not receive it in 1973. No stale claim needed to be litigated. A Court had already held that no tax was owning on the income for 1973 because the income was held to have been received in 1972. In *Bull*, if it was corpus, it was not income. In *Dalm* if income, it was not a gift. When a court determined one it determined the other. Far from stale claims needing to be litigated, no claim needs to be litigated at all. All necessary issues have been determined. The Internal Revenue Service should have allowed the credit when it proceeded for income tax and is duty bound to refund the incorrect tax. Having neglected or refused to do so an action will lie to force compliance. Not only did the Court of Appeals do equity it followed a principal of fundamental fairness established by this Court the Government seeks to eliminate from tax administration.

CONCLUSION

The *Dalm* case has been rightly decided. Therefore, the decision of the Court of Appeals should be affirmed.

Respectfully submitted,

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No. 88-1951

In the Supreme Court of the United States

OCTOBER TERM, 1989

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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In our opening brief, we point out (Br. 10) that respondent did not file her claim for a refund of gift tax within the period required by the applicable statute of limitations. 26 U.S.C. 6511.[1] Since respondent failed to act within the limitations period, there is no statutory basis for jurisdiction over this suit, and the district court therefore properly dismissed it. Br. 8-11. We also show that the doctrine of equitable recoupment, as applied by this Court in tax cases, provides no basis for jurisdiction over an independent, time-barred refund suit such as respondent's. Br. 11-19. Rather, that doctrine allows a tax claim over which a court properly has jurisdiction "to be examined in all its

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

aspects." *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296, 299 (1946). In such a case, where jurisdiction properly lies, a party may offer the existence of a previous overpayment as an equitable reason why the deficiency being litigated should be reduced. Respondent's proposed expansion of the doctrine of equitable recoupment would not only eviscerate clear jurisdictional limitations, it would also render nugatory the restrictions that Congress has imposed upon the availability of relief under the mitigation provisions of the Internal Revenue Code, I.R.C. §§ 1311-1314. Br. 25-27. Finally, we show in our opening brief that the jurisdictional limitations do not operate unfairly here. Respondent could have pursued a procedural course that would have permitted her properly to invoke the doctrine of equitable recoupment; she simply failed to do so. Br. 30-34.

Respondent's brief does not squarely address these arguments. Instead, she makes several contentions which, as we shall show, either lack merit or miss the point.

1. Respondent argues, first, that this case is indistinguishable from *Bull* v. *United States*, 295 U.S. 247 (1935), because in both cases the taxpayer paid a non-income tax, the government then asserted an income tax deficiency, and the taxpayer unsuccessfully opposed the deficiency in the Tax Court or its predecessor (the Board of Tax Appeals) and then filed a claim and suit for refund.

Respondent's contention overlooks the critical distinction between *Bull* and this case. In *Bull*, the taxpayer followed the correct procedure for challenging the amount of income tax deficiency. Under the pre-1926 law applicable in that case, a taxpayer could petition the Board of Tax Appeals to review a deficiency asserted by the Commissioner and, if unsuccessful, file a refund claim and obtain de novo review in a district court or the Court of Claims. See Sections 274(a), (b), and (c), 308(a), (b),

and (c), 900(g), 1025 of the Revenue Act of 1924, ch. 234, 43 Stat. 297, 308-309, 337, 348. As a consequence, the district court in *Bull* properly had jurisdiction over the income tax refund suit.

That is not the case here. As noted in our opening brief (Br. 13 n.6), the law no longer allows a taxpayer resort to two different forums to contest the same income tax deficiency. Sections 284(d), 1001-1003 of the Revenue Act of 1926, ch. 27, 44 Stat. 67, 109-110, made the decisions of the Board of Tax Appeals (now the Tax Court) final, subject only to appellate review by the courts of appeals and this Court. Thus, once respondent filed a petition in the Tax Court for redetermination of her *income* tax liability for 1976 and 1977, she was precluded from thereafter suing for a refund in respect of that liability. I.R.C. § 6512(a); *Elbert* v. *Johnson*, 164 F.2d 421 (2d Cir. 1947); Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 599 n.20, 614-615 (1986). To circumvent this obstacle, respondent instead filed a tardy claim and brought suit for a refund of the *gift* tax she had paid. Because that claim was time-barred, the district court lacked jurisdiction and properly dismissed the suit.

Far from being a "meaningless procedural distinction" (Resp. Br. 2), the difference between filing a timely claim (as did the taxpayer in *Bull*) and failing to file such a claim (as did respondent here) is the difference between preserving jurisdiction in the district court to consider a claim of equitable recoupment and failing to preserve that jurisdiction. Indeed, with proper attention to the significance of that difference, equitable recoupment remains fully available under modern procedure—contrary to respondent's contention that only her position would maintain the vitality of the doctrine. If instead of proceeding in the Tax Court, respondent had paid the 1976 and 1977 income tax

deficiencies and then brought a timely refund suit in district court or the Claims Court, she could properly have invoked *Bull*'s doctrine of equitable recoupment to diminish the amount of the income tax deficiency by the amount of the gift tax she had paid.[2] Having failed to follow this available course, however, she should not now be heard to complain about the consequences that attend her choice of forum and remedies.[3]

2. Respondent next argues that her action was, in fact, timely. According to respondent, since no gift tax was actually due in 1976, there was no "payment" of gift tax in that year for purposes of Section 6511 of the Code. Rather, without citation of authority, respondent asserts that when two taxes have been paid with respect to a single transaction under inconsistent theories of taxation, the "improper tax" somehow "becomes paid"—and therefore triggers the running of the limitations period—only at the time that the proper tax has been determined. Resp. Br. 6. Accordingly, respondent contends that her cause of action "arose" only in 1984 when the income tax was collected (Resp. Br. 8) because "the gift tax only became refundable upon the payment of income tax on the same sum of money because *then and only then* was the gift tax overpaid." Resp. Br. 7 (emphasis in the original).

Respondent's view accords neither with the statute nor with common sense. There is no statutory support for the notion that some taxes are not deemed paid until actions

[2] Hence, there is no basis for respondent's assertion that she has had "no fair opportunity to be heard." Resp. Br. 9.

[3] Indeed, to allow respondent to maintain an untimely suit in the district court after litigating her income tax deficiency in the Tax Court would give respondent "two bites at the apple" of reducing her liability on the "single transaction" or taxable event that she asserts is at issue. To the contrary, Congress determined in 1926 to limit taxpayers to one forum of their choice.

by the government make it clear that the payments were erroneous. To the contrary, Section 6511 of the Internal Revenue Code states simply that the limitations period on filing a claim for refund runs "3 years from the time the return was filed or 2 years from the time the tax was paid," whichever period expires later. Consistently with the plain language, a tax is "paid" under the Code when the Commissioner receives a check in payment of the tax (unless the check is subsequently dishonored). See I.R.C. §§ 6151, 6311.

Common sense does not support the notion that no payment of gift tax occurs when a tax so labeled is paid on an item that does not warrant it; rather, a gift tax has simply been paid erroneously. Payment of an income tax in this case did not "render[] the original payments improper" (Resp. Br. 7)—to the extent they were improper, they were improper and refundable from the time the original gift tax payments were made. Payment of the second tax simply made evident the improper nature of the first tax. Even at that time, a remedy is readily at hand—a claim of equitable recoupment could properly have been raised in the context of a suit for refund of the second tax (a course respondent did not follow).[4]

A contrary holding—that an erroneous tax has not been paid until it has been determined whether the payment was erroneous—would eviscerate the statute of limitations, which by its very nature is intended to bar untimely tax refund claims without consideration of the question whether

[4] A taxpayer can also file a protective claim for refund or obtain an extension of the limitations period from the IRS if there is reason to believe that there will be a determination after the expiration of the limitations period that will bear on his or her right to refund. See M. Saltzman, *IRS Practice and Procedure* § 11.08[3] (1981); I.R.C. § 6511(c); *O'Brien* v. *United States*, 766 F.2d 1038, 1041 n.3 (7th Cir. 1985).

the taxes sought to be refunded were properly imposed. And, if respondent were correct, the mitigation provisions enacted by Congress would be superfluous, as no limitations period would bar correction of inconsistent tax treatment of income.

In a further attempt to support her claim that the instant suit is timely, respondent argues (Resp. Br. 9) that the government "has waived any sovereign immunity by bringing an action [*i.e.*, by asserting income tax deficiencies for 1976 and 1977] against the Dalms," and has thereby "opened itself up to claims of recoupment against that deficiency." To be sure, Congress has waived sovereign immunity and provided taxpayers with remedies when tax deficiencies are asserted against them. Respondent chose to take advantage of this waiver by proceeding in the Tax Court (instead of in a district court or the Claims Court following payment of the tax) to challenge the imposition of income tax deficiencies against her. But, as we have explained (pp. 3-4, *supra*), respondent's choice of the Tax Court forum precluded her from claiming equitable recoupment against the income tax deficiency.[5]

[5] Respondent errs in relying (Resp. Br. 7-8) on *Elbert* v. *Johnson*, 164 F.2d 421 (2d Cir. 1947); indeed, the holding in that case accords with our position. The taxpayers there sought to recover a prior gift tax payment by invoking equitable recoupment in a Tax Court proceeding concerning income tax liability arising out of the same transaction. The Tax Court determined that it lacked jurisdiction to grant equitable recoupment. 164 F.2d at 423; see *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943). The taxpayers then sought to raise the recoupment claim by filing an income tax refund action. The district court dismissed for lack of jurisdiction; the court of appeals affirmed. Assuming that the taxpayers could have raised an equitable recoupment claim if they had filed suit without resorting first to the Tax Court (*Elbert*, 164 F.2d at 423), the court held their refund suit barred by Section 322(a) of the 1939 Code, 26 U.S.C. (1952), the provision which at the time prohibited a refund action with respect to a tax that was the subject of a prior Tax Court proceeding. (The provision is currently codified at I.R.C. § 6512(a).)

Respondent cites a passage that is dictum within a concurring opinion. Resp. Br. 8 (citing *Elbert*, 164 F.2d at 425). The concurrence, while right in result, is incorrectly premised on the assumption that equitable recoupment can "toll" the limitations period for challenging a previously paid tax, independent of timely litigation over a subsequently paid tax. To the contrary, this Court stated in *Bull* that inconsistent treatment of a particular transaction "cannot avail to toll the statute of limitations." 295 U.S. at 259.

3. In *Bull*, this Court observed that the defense of equitable recoupment is never barred by a statute of limitations "so long as the main action itself is timely." 295 U.S. at 262. Respondent contends (Resp. Br. 16-17) that the "main action" for this purpose is the government's assertion of an income-tax deficiency. Because her suit "follow[s] a timely assertion of a deficiency on the part of the government," respondent argues that it is not an "independent action" within the meaning of cases holding that the doctrine of equitable recoupment cannot provide an independent basis for jurisdiction over an otherwise time-barred suit. Resp. Br. 13-16.[6]

Respondent's argument fundamentally misconceives how the doctrine of equitable recoupment operates. As we explain in our opening brief (Br. 18-19), the "main action" is an action over which the court properly has jurisdiction (which requires, *inter alia*, that it be brought upon a timely claim). A time-barred claim may be asserted *in the main action* as a defense or offset against the timely claim under the doctrine of equitable recoupment, provided that the untimely claim arises from the same transaction as the

[6] *O'Brien* v. *United States*, 766 F.2d 1038, 1048-1051 (7th Cir. 1985); *Ellard* v. *United States*, 228 Ct. Cl. 815 (1981); *Brigham* v. *United States*, 470 F.2d 571, 577 (Ct. Cl. 1973), cert. denied, 414 U.S. 831 (1973); *Evans Trust* v. *United States*, 462 F.2d 521, 526 (Ct. Cl. 1972).

timely claim.[7] Thus, under the rationale of *Bull*, a deficiency asserted by the government may provide the basis for a "main action" if the deficiency is actually assessed and either the taxpayer fails to pay it and the government brings a timely collection action thereon, or the taxpayer pays the deficiency, files a timely claim for refund, and then brings a timely refund suit. See *Bull*, 295 U.S. at 260-262. In either of these events, the pending refund or collection suit would be the "main action" within the meaning of *Bull*, and the taxpayer could seek to "recoup" an appropriately related, time-barred refund claim against the tax liability asserted by the government—as a *defense* in the pending action challenging the government's deficiency determination.

On the other hand, as we have explained (U.S. Br. 28), the existence of a timely asserted deficiency claim is neither a necessary nor a sufficient element of an equitable recoupment claim. Respondent thus overlooks the premise of statements she quotes which note that equitable recoupment "permits a taxpayer to recoup an erroneously paid tax * * * against a timely and correctly asserted deficiency by the government." Resp. Br. 16 (quoting *O'Brien* v. *United States*, 766 F.2d 1038, 1049 (7th Cir. 1985)). The point of such statements is that equitable recoupment can be invoked when there is a claim that is still being or can properly be litigated—such as a deficiency that is still "open" against which a time-barred overpayment can be

[7] All of the cases invoked by respondent (see Resp. Br. 17 n.1) that were cited in *Bull* make the same point that equitable recoupment is in the nature of a *defense*. Hence, a recoupment claim does not resurrect an untimely independent refund claim; rather, it reduces a presently owed debt. See *Williams* v. *Neely*, 134 F. 1, 5 (8th Cir. 1904) ("Recoupment is the keeping back of something that is due because there is an equitable reason for holding it.").

recouped.[8] Here, respondent has effectively barred herself from bringing a recoupment claim: after her petition in the Tax Court, there can be no "open" deficiency that she can continue to litigate. The Tax Court's determination of the deficiency is final, and respondent's subsequent suit can only be an "independent action" on a time-barred claim.[9]

4. Respondent misperceives the thrust of our argument regarding the significance of the "mitigation provisions" of the Internal Revenue Code (I.R.C. §§ 1311-1314). Our position is not that those provisions provide "the exclusive remedy when inconsistent positions of the

[8] In particular, respondent errs in relying on *O'Brien* as supporting the notion that equitable recoupment can be invoked to confer jurisdiction over an independent suit following the entry of a Tax Court decision. See Resp. Br. 16-17 (quoting *O'Brien*, 766 F.2d at 1050). The court in *O'Brien* was positing only that the invocation of equitable recoupment "might have been correct * * * in the 1975 [Tax Court] proceeding which resolved the dispute over stock valuation for estate tax purposes"—though invocation of the doctrine clearly was not correct after that proceeding in an independent suit for an income tax refund based on the corrected stock valuation. Correctly identifying the nature of equitable recoupment as a *defense* in a properly instituted suit, the *O'Brien* court simply declined to determine "whether the Tax Court currently possessed the equitable jurisdiction necessary to apply the equitable recoupment doctrine." 766 F.2d at 1050 n.15.

[9] Respondent notes that her gift tax refund claim was filed before the decision was entered in her Tax Court proceeding, arguing that her claim is thus one in recoupment that survives as long as the claim against which it may be asserted survives. Resp. Br. 17-18. Obviously, so long as the possibility remains that a court may obtain jurisdiction over a suit brought on the main claim, the possibility also remains that an appropriately related, though time-barred, claim might then be asserted *in that suit* as a defense against the main claim under the doctrine of equitable recoupment. It in no way follows, however, that the doctrine of equitable recoupment will support an independent action brought on a time-barred claim merely because that claim was filed while different proceedings on the main claim were still pending.

Internal Revenue Service subject a Taxpayer to double taxation." Resp. Br. 18-19. Rather, it is that if, as respondent contends and the court below held, equitable recoupment permits a taxpayer to bring an independent action on a time-barred claim for a refund of taxes assertedly overpaid merely because of inconsistent treatment by the Commissioner, it would have been pointless for Congress to have enacted the mitigation provisions because such actions could simply have been brought under the doctrine of equitable recoupment. Moreover, such an expansive view of equitable recoupment would render nugatory the carefully crafted restrictions that Congress imposed upon the availability of relief under the mitigation provisions. The very existence of the mitigation provisions confirms that the court of appeals' approach to equitable recoupment in this case was wrong. See U.S. Br. 25-27.[10]

5. Finally, respondent erroneously argues (Resp. Br. 20-23) that permitting her to pursue her time-barred refund claim would not contravene the underlying policy of the statute of limitations to preclude stale claims. Resp. Br. 20-23. We agree that both the payment of the gift tax by respondent and the later assessment of a deficiency and payment of another tax concerned one transaction that could have been examined "in all of its aspects" without offending the policies underlying the statute of limitations. Respondent, however, did not initiate such an

[10] Respondent further asserts (Resp. Br. 20) that "the Government seeks to use the statute of limitations in the precise manner disapproved of by Congress," that is, by "seek[ing] to make a profit [by] taking inconsistent positions." The government, however, has never taken inconsistent positions as respondent suggests. The record here plainly shows that since he examined the payments by Clarence Schrier to respondent, the Commissioner of Internal Revenue has steadfastly maintained that the payments were income to respondent for her services as administratrix of the estate of Harold Schrier.

inquiry into "all of [the] aspects" of the timely income tax controversy. Rather, while she labels her claim one of recoupment—*i.e.*, one "in the nature of a defense" to the income tax deficiency—she raises it after final determination of that deficiency. Such an action cannot be reconciled with the policy of repose effectuated by statutes of limitations. Further, respondent's stratagem would multiply litigation that could have been resolved in one suit. In any event, respondent's policy-based plea cannot negate the clear statutory language enacted by Congress which bars suits for refund such as this one, filed long after the challenged taxes were paid.

For the foregoing reasons, and those presented in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

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